United States Court of Appeals

for the Second Circuit

AMICUS BRIEF

74-1043

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-1043

RICHARD A. GORDON, etc.,

Plaintiff-Appellant,

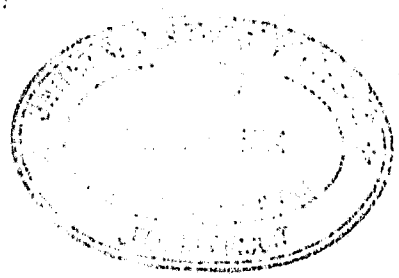
v.

NEW YORK STOCK EXCHANGE, INC., et al.,

Defendants-Appellees.

Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION,
AMICUS CURIAE



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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

The United States Securities and Exchange Commission submits this brief, amicus curiae, to discuss the following questions:

(1) Whether the rules of national securities exchanges relating to fixing minimum rates of commission charged by their members for executing transactions on those exchanges are within the purview of exchange self-regulatory conduct subject to the quasi-legislative supervisory jurisdiction of the Securities and Exchange Commission under Section 19(b) of the Securities Exchange Act of 1934?

(2) Whether the statutory scheme of supervised self-regulation of securities exchanges embodied in the Securities Exchange Act of 1934 preempts the application of the antitrust laws to those practices

of securities exchanges that are subject to the quasi-legislative, jurisdiction of the Securities and Exchange Commission?

COUNTERSTATEMENT OF THE CASE

On April 2, 1971, Richard A. Gordon instituted this private antitrust action against the New York Stock Exchange, Inc. ("NYSE"), the American Stock Exchange, Inc. ("AMEX"), and two "representative" member firms of these securites exchanges,[1] charging that certain practices of the defendants relating to the exchanges' fixed minimum commission rate system were in violation of the Sherman Act, 15 U.S.C. 1 and 2, and of the Robinson-Patman Act, 15 U.S.C. 13(a) (4-6a).[2] The suit, which was brought by plaintiff on his own behalf and on behalf of a purported class of "small investors," sought both injunctive relief and treble damages in the amount of $1.5 billion (7-8a). In his complaint, plaintiff specifically attacked, as in violation of the federal antitrust laws, rules of the defendant exchanges which (1) provided for a "volume discount" from the minimum commission rate on large transactions executed on the exchanges, (2) imposed an

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1/ The two member firms named as defendants in the complaint were Merrill Lynch, Pierce, Fenner & Smith, Inc., and Bache & Co., Inc.

2/ "___a" refers to pages of the Appendix to appellant's brief. References to appellant's brief are cited as "G. Br. __." References to the amicus curiae brief filed by the Antitrust Division of the United States Department of Justice are cited as "Div. Br.__."

interim "surcharge" on the execution of "small transactions" of less than 1,000 shares, and (3) authorized exchange members to negotiate the commission to be charged on that portion of a transaction in excess of $500,000 (now $300,000) while continuing to maintain a fixed minimum commission rate for smaller transactions (4-6a). Plaintiff also challenged provisions of the defendant exchanges' rules imposing a limitation on exchange membership while prohibiting access of non-member brokers to exchange facilities at a discounted commission rate and forbidding members to share commissions with non-members (5a).

On December 4, 1973, the District Court for the Southern District of New York (per Lasker, J.) granted defendants' motion for summary judgment and entered an order dismissing the action for lack of subject matter jurisdiction (340a). Characterizing the suit as "a broadside attack on the present commission structure of the Exchanges" (341a),[3/] the opinion below rejected each of plaintiff's claims.[4/] With respect to the limitation on exchange membership and non-member access, the court concluded that plaintiff lacked standing under Section 4 of the Clayton Act, 15 U.S.C. 15, to assert this claim, since he

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3/ The district court's opinion is reported at CCH Fed. Sec. L. Rep. [1973 Transfer Binder] ¶ 94,235.

4/ We believe that the district court properly viewed the complaint as an attack on the exchanges' fixed minimum commission rate structure. For each of the specific actions alleged in the complaint is merely an element of that rate structure, and would not have occurred except in the context of a fixed minimum commission rate system. See 52-64, 193-200a; see also p. 39 - 53, infra.

"has never made an application for membership in either defendant Exchange . . . ." (342a). The court further concluded (343a) that Section 3(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78c(a)(3), makes clear that the Act contemplates a limitation on non-member access to exchange facilities by defining a "member" as, inter alia, "any person who is permitted . . . to make use of the facilities of an exchange for transactions thereon without payment of a fee or with payment of a commission or a fee which is less than that charged the general public. . . ." (343a). As to the charge of unlawful price discrimination between "large" and "small" transactions, the court found (344a) that the Robinson-Patman Act was inapplicable, since that statute "requires that the alleged price discrimination be in connection with 'commodities of like grade and quality' . . . [and] that services and intangibles (such as stock trade executions) are not 'commodities' within the meaning of the Act." 5/

Finally, Judge Lasker ruled in accordance with the defendants' position that the district court, in any event, lacked jurisdiction to entertain plaintiff's antitrust attack because "the practices complained of are within the exclusive jurisdiction of the Securities

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5/ See, e.g., Baum v. Investors Diversified Services, Inc., 409 F. 2d 872, 875 (C.A. 7, 1969).

and Exchange Commission, that the SEC, acting pursuant to §19(b) of the Exchange Act . . ., has been actively regulating these practices, and that, consequently, the practices are exempt from the provisions of the antitrust laws . . . ." (342a). In this regard, the court held that "the fixing of commissions falls squarely within the congressional policy of exchange self-regulation embodied in the 1934 Act" (346a), and that "the power to fix commission rates" was placed "within the exclusive jurisdiction of the Exchange, subject to commission supervision" (347a).

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The basic issue presented in this case is whether features of a national securities exchange's commission rate structure, adopted and maintained pursuant to the process of supervised self-regulation established in the Securities Exchange Act, are subject to antitrust attack. The resolution of this issue is of major importance to the continued viability of the regulatory scheme embodied in the Exchange Act. As the federal agency charged with the responsibility for administering the Exchange Act, the Commission has a substantial interest in assuring that reconciliation of the antitrust laws with the statutory scheme of regulation in the Exchange Act will not impair the ability of national securities exchanges to execute their congressionally-mandated functions of self-regulation. Moreover, resolution of the question of pre-emption of the antitrust laws

in favor of the Commission's quasi-legislative jurisdiction will have a material impact upon the effective exercise by the Commission of its supervisory authority over national securities exchanges, not just with respect to stock exchange commission rates, but also as to the entire range of exchange activities that are made subject to the Commission's quasi-legislative authority under the Exchange Act. For the application of antitrust standards and the possibility of ad hoc judicial decrees affecting exchange self-regulatory activity subject to the Commission's supervision will necessarily limit the Commission's continued ability to formulate and effectuate a cohesive policy for the securities industry.

As we shall show in Point I of this brief, the Securities Exchange Act was intended to impose a unique scheme of supervised self-regulation upon securities exchanges through which these essentially monopolistic entities were entrusted with regulation of their own operations subject, however, to the quasi-legislative supervisory authority of the Securities and Exchange Commission. And the legislative history of the Act makes clear that the fixing of commission rates by securities exchanges was a matter specifically intended by Congress to be within the exchanges' self-regulatory mandate and subject to the Commission's quasi-legislative jurisdiction.

In Point II of this brief, we will demonstrate that application of the antitrust laws to rules of a national securities exchange, where those rules have been adopted and maintained through the process of supervised self-regulation, is repugnant to the regulatory scheme under the Exchange Act, and that an antitrust action is not required in order to provide a means for review of the practice of fixing minimum rates of commission on national securities exchanges.

ARGUMENT

I. THE AIM AND STRUCTURE OF THE SCHEME OF SUPERVISED SELF-REGULATION ESTABLISHED IN THE SECURITIES EXCHANGE ACT OF 1934

A. The "Genesis" of the Securities Exchange Act

As the Supreme Court has recognized, the process of reconciling the antitrust laws with a federal regulatory statute, such as the Securities Exchange Act, necessarily requires a searching inquiry into the genesis and aims of the federal regulatory act.[6/] Thus, in order to resolve the issue of implied repeal of the antitrust laws presented in this case, we first examine the legislative history of the Securities Exchange Act.[7/]

It is the Commission's contention, as discussed below, that the legislative history of the Securities Exchange Act clearly evidences that (1) Congress sought by the Act to entrust securities exchanges--which it knew to be essentially monopolistic entities--with the responsibility in the first instance for regulation of their operations and their members' conduct, that (2) Congress intended that the mandate of self-regulation imposed upon the exchanges be subject to a quasi-legislative supervisory jurisdiction vested in the Securities and Exchange Commission, and that (3) one of the features of exchange operations of which

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6/ See, e.g., Federal Maritime Commission v. Seatrain Lines, Inc., 411 U.S. 726, 732, 736-739 (1973); Otter Tail Power Co. v. United States, 410 U.S. 366, 373-74 (1973); Philadelphia Nat'l Bank v. United States, 374 U.S. 321, 350-52 (1963); United States v. R.C.A., 358 U.S. 334, 339-346 (1959). See also Merrill Lynch, Pierce, Fenner & Smith, Inc., v. Ware, 94 S. Ct. 383, 389-390 (1974).

7/ See Silver v. New York Stock Exchange, Inc., 373 U.S. 341, 361 (1963). See also Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, supra, 94 S. Ct. at 389-390.

Congress was specifically aware in formulating the Exchange Act and which was purposely brought within the scope of the scheme of supervised self-regulation created by the Act, was the exchanges' practice of fixing minimum rates of commission.

While Congress considered regulating stock exchanges on several occasions during the three decades prior to 1934, [8/] the immediate impetus to legislation was the uncovering of serious instances of irresponsibility displayed by exchange members during 1929 and the early thirties. [9/] Early in his first administration President Franklin Roosevelt directed the formation of a committee, under the aegis of Daniel C. Roper, then Secretary of Commerce, to study regulation of stock exchanges. [10/] The report of this committee, the Roper Report, specified two major imperatives that should be adhered to in any scheme for federal regulation of the stock exchanges. The report first concluded that since stock exchanges "do not present a static situation susceptible to fixed standards" but are rather "a highly dynamic, ever changing picture, subject to untold and unknown possibilities and combinations that are today unpredictable" it would be inappropriate "to place this complex

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8/ See Merrill Lynch, Pierce, Fenner & Smith, Inc., v. Ware, supra, 94 S. Ct. at 390 n. 9; see generally R. De Bedts, The New Deal's SEC; The Formative Years Ch. 1 (1964) [hereinafter cited as De Bedts].

9/ De Bedts at 9-29.

10/ Letter from the President of the United States to the Chairman of the Committee on Banking and Currency with an Accompanying Report Relative to Stock Exchange Regulation, 73d Cong., 2d Sess. iii (Committee Print 1934) [hereinafter cited as the Roper Report]. The platform adopted by the Democratic Party Convention in July 1932 called for "Regulation, to the full extent of federal power, of . . . (c) Exchanges in securities and commodities." De Bedts at 24-25.

and important mechanism in a strait jacket."[11] Therefore, the committee stated, ". . . while certain provisions [to remedy abusive practices on the exchanges] might be included in any regulations, such provisions should not be the only power of correction left open to an administrative agency [regulating exchanges], but it should have broad discretion to operate directly on various abuses as the future may prove them to exist."[12]

The Roper Report further concluded, however, that it would be undesirable to "deprive" the exchanges "of initiative and responsibility" in dealing with their members.[13] Rather, in the opinion of the committee, it appeared "distinctly better" to hold an exchange "to a high degree of accountability for the conduct of members" in order to stimulate meaningful exchange regulation of its members.[14]

Both of these imperatives were accorded recognition in the committee's recommendation for a system of federal licensing

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11/ Roper Report at 6.

12/ Id.

13/ Id. at 8.

14/ The Supreme Court has suggested that one of the reasons for this policy of encouraging self-regulation by exchanges was the prohibitive cost to the federal government that any program of complete federal regulation would have. See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, supra, 94 S. Ct. at 390 n. 9.

of securities exchanges whereby

> "all exchanges desiring a Federal license must adopt and submit to the proposed Stock Exchange Authority for its approval, rules designed to comply with the regulatory requirements outlined by the proposed statute and with such rules and regulations as may be promulgated by the proposed stock exchange authority thereunder. Furthermore, as a condition of retaining a license an exchange would be required to abide by and enforce such regulatory requirements and such rules and regulations. Any exchange would be permitted to adopt any other or additional rules and regulations not inconsistent with the regulatory requirements outlined by the statute or the rules and regulations promulgated by such proposed Stock Exchange Authority." 15/

Following publication of the Roper Report 16/ legislation was introduced in both the House and Senate, 17/ which provided for the licensing and disciplining of securities exchanges, and vested broad discretionary authority in the regulatory agency over, in effect, the entire range of exchange operations. 18/

15/ Roper Report at 11.

16/ For a historical description of the drafting of the Exchange Act, see De Bedts, Ch. III.

17/ The Exchange Act was originally introduced as H.R. 7852, 73d Cong., 2d Sess. (1934), and S. 2693, 73d Cong., 2d Sess. (1934). Following extensive hearings, these bills were revised and reintroduced as H.R. 8720, 73d Cong., 2d Sess. (1934), H.R. 9323, 73d Cong., 2d Sess. (1934), and S. 3420, 73d Cong., 2d Sess. (1934). H.R. 9323 and S. 3420, in amended form, became the Securities Exchange Act.

18/ See H.R. 7852 and S. 2693, Sections 5 and 18(c); and H.R. 8720, Sections 5 and 18. Pertinent sections of these bills, as well as other relevant publicly available materials are set forth in the Documentary Appendix to this brief. References to material contained in the Documentary Appendix are cited as (Doc. App. ____.)

This grant of broad discretionary authority to the federal regulating agency contained in the early drafts of the legislation, received both support [19/] and criticism [20/] during the congressional hearings held on these bills. The principal criticism raised was that these bills would impose greater federal regulation of the exchanges than had been contemplated in the recommendations made in the Roper Report, providing for what one critic characterized as "not regulation but domination." [21/] In fact, the drafters of the legislation acknowledged that they had struck a different balance between direct federal regulation and exchange self-regulation than had the Roper Report, [22/] since

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19/ See Hearings Before the Senate Committee on Banking and Currency on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.), 73d Cong., 1st and 2d Sess. 6868 (1933-1934) (Statement of G. Herman Kinnicutt, member of Investment Bankers Association, New York, N.Y.) [hereinafter cited as Senate Hearings]; Id. at 7256 (Statement of A. Verle Shaw).

20/ See Hearings Before the House Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720, 73d Cong., 2d Sess. 227 (1934) (Statement of Richard Whitney, President of the New York Stock Exchange) [hereinafter cited as House Hearings]; Senate Hearings 6638-39 (Statement of Richard Whitney, President of the New York Stock Exchange), 6901-6915 (Statement of Frank R. Hope, President of the Association of Stock Exchange Firms).

21/ See Senate Hearings 6638-39; House Hearings 227.

22/ See House Hearings 26-27 (Statement of Hon. H. M. Landis, Commissioner, Federal Trade Commission).

the bills would give the Commission power "to step in and prescribe the rules under which the exchange shall operate in practically all particulars respecting the investing public."[23] This regulatory scheme was justified, it was argued, on the grounds that it was necessary to empower the Commission "to step in in the event the Commission finds the method of operation being undertaken by the exchange unsatisfactory to it" and to this end the Commission should have a power of intervention short of revoking an exchange's license.[24]

It was in this context--a debate on the proper balance that ought to be struck between direct federal regulation of stock exchanges and self-regulation of the exchanges--that the Congress specifically focused on the fact that the stock exchanges were monopolistic in nature and that any federal regulation of the exchanges should involve regulation of their monopolistic features in general, and the exchanges' practices of fixing minimum commission rates in particular. Thus, the practice of fixing minimum commission rates was described in the congressional hearings,[25] and the appropriateness

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23/ Senate Hearings 6566 (Statement of Thomas G. Corcoran).

24/ Senate Hearings 6566-6570 (Statement of Thomas G. Corcoran).

25/ Senate Hearings 6075, 6080; House Hearings 320-321, 423.

of federal regulation of the exchanges' fixed rate system was the subject of discussion during those hearings.[26] Indeed, one of the leading authorities of the time on stock exchange operations, Samuel Untermeyer, made the following recommendations with respect to stock exchange rate fixing:

> "While section . . . [18] of your bill [S.2693] would give the Federal Trade Commission the right to prescribe uniform rates of commission, it does not otherwise authorize the Commission to fix rates, which it seems to me it should do and would do by striking out the word 'uniform.' That would permit the Commission to fix rates.
>
> "The volume of the business transacted on the exchange has increased manyfold. Great fortunes have been made by brokers through this monopoly. The public has no access to the exchange by way of membership except by buying a seat and paying a very large sum for it. Therefore it is a monopoly. Probably it has to be something of a monopoly. But after all it is essentially a public institution. It is the greatest financial agency in the world, and should be not only controlled by the public but it seems to me its membership and the commission charged should either be fixed by some governmental authority or be supervised by such authority. As matters now stand the exchange can charge all that the traffic will bear, and that is a burden upon commerce."[27]

Senate Hearings 7705 (emphasis added).

26/ Compare Senate Hearings 6868 (where the witness recommended against giving the federal regulatory agency "control over commission charges" on the ground that such control "must be left as [a matter] of self-preservation to the exchanges and their members") with id. at 7705.

27/ Mr. Untermeyer had been counsel to a subcommittee of the House Committee on Banking and Currency, 62d Congress, which in 1912 and 1913 made an extensive investigation of stock exchange operations. The resulting report from this committee--H.R. Rep. No. 1593, 62d Cong., 3d Sess. (1913), known as the Pujo Report after its Chairman--specifically dealt with the NYSE's practice of commission rate fixing, noting

(footnote continued)

The original bills were revised in response to the criticisms and suggestions made in the hearings so that the legislation,

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(footnote continued)

that:

> "The rule is rigidly enforced by suspension from one to five years for a first violation and expulsion for a second. . . . The acknowledged object is to prevent competition amongst the members."

Id. at 39. The Pujo Report advised against any congressional action proscribing this practice both because the practice was regarded as having only local effect (and thus presumably beyond Congress' power to reach) and because the committee believed

> "the present rates to be reasonable, except as to stocks, say, of $25 or less in value, and that the exchange should be protected in this respect . . . against a kind of competition between members that would lower the service and threaten the responsibility of members. A very low or competitive commission rate would also promote speculation and destroy the value of membership."

Id. at 115-116. (emphasis added).

The conventional wisdom concerning the propriety of the fixed commission rate system was the same at the time of the enactment of the Securities Exchange Act. Thus, a comprehensive study of the operations of the exchange market published in 1935 made the following observation with respect to the fixed rate system:

> "Among the provisions [of the NYSE's rules and constitution] specifically regulating the brokers in their relations with each other, there is the requirement of minimum commission charges. This serves the double purpose of making unfair competition among brokers punishable and of providing better and cheaper service to the public. The prohibition against splitting commissions has served to do away, in part at least, with unnecessary middlemen who are beyond the control of the Exchange. It has also kept the larger part of the brokerage business in the hands of the brokers rather than permitting it to drift into the hands of banks."

(footnote continued)

as reported out of the respective House and Senate committees, [28/] struck a balance between self-regulation and direct federal regulation of stock exchanges somewhat more akin to the position expressed in the Roper Report than that contained in the initial version of the bills.

(footnote continued)

The Twentieth Century Fund Inc., The Security Markets 226 (1935) (emphasis added).

An earlier publication of the Twentieth Century Fund's findings, Twentieth Century Fund, Stock Market Control (1934), was repeatedly relied upon in the drafting and consideration of the Securities Exchange Act. See, e.g., Senate Hearings 6467; 78 Cong. Rec. 8031-8032 (remarks of Mr. Pettengill); 8180 (remarks Senator Fletcher); 8395 (remarks of Senator Barkley) (1934).

28/ H.R. 9323, 73d Cong., 2d Sess. (1934) and S. 3420, 73d Cong., 2d Sess. (1934).

Thus, as the House report explained, "the bill gives the Commission broad powers over the exchanges to insure their efficient and honest functioning" because as economic forces affecting speculation converge "upon the exchanges, the control of the exchange mechanism is a necessary part of any effective regulation." H. R. Rep. 1383, 73d Cong., 2d Sess. 14 (1934) [hereinafter cited as H. R. Rep. No. 1383]. 29/ "[I]f the rules of the exchange in any important matter are not appropriate for the protection of investors or appropriate to insure fair dealing, [the Commission is empowered] to order such changes in the rules after due notice and hearings as it may deem necessary." 30/

29/ One of the basic purposes of the Exchange Act was the establishment of "an efficient, adequate, open and free market for the purchase and sale of securities. . . .," 78 Cong. Rec. 8162 (Remarks of Senator Fletcher) (1934), and control of the exchange mechanism was regarded as essential to achieving that purpose. See 78 Cong. Rec. 7862 (remarks of Mr. Lea); 7864 (remarks of Mr. Wolverton); 8161, 8163 (remarks of Senator Fletcher) (1934).

30/ H. R. Rep. No. 1383 at 15.

At the same time, however, the House report emphasized that the bill was designed to leave "a wide measure of initiative and responsibility . . . with the exchanges" and that the power granted the Commission over exchange rules was a "reserved control" to be exercised "if the exchanges do not meet their responsibility."[31/] In sum, it was hoped "that the effect of the bill [would be] to give the well-managed exchanges that power necessary to enable them to effect themselves needed reform and that the occasion for direct action by the Commission will not arise."[32/]

31/ H.R. Rep. No. 1383 at 15.

32/ H.R. Rep. No. 1383 at 15. The Supreme Court, in characterizing the scheme of self-regulation established by the Exchange Act, has stated:

> "The pattern of governmental entry, however, was by no means one of total displacement of the exchanges' traditional process of self-regulation. The intention was, rather, as MR. JUSTICE DOUGLAS said, while Chairman of the S.E.C., one of 'letting the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used.' Douglas, Democracy and Finance (Allen ed. 1940), 82. Thus the Senate Committee Report stressed that 'the initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves. It is only where they fail adequately to provide protection to investors that the Commission is authorized to step in and compel them to do so.' S. Rep. No. 792, supra, at 13. The House Committee Report added the hope that the bill would give the exchanges sufficient power to reform themselves without intervention by the Commission. H.R. Rep. No. 1383, supra, at 15. See also 2 Loss, Securities Regulation (2d ed. 1961). 1175-1178, 1180-1182."

Silver v. New York Stock Exchange, Inc., supra, 373 U.S. at 352. See also Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, supra, 94 S. Ct. at 390-91.

Nevertheless, the sponsors of the legislation stressed that it was necessary throughout the bill to vest "broad discretionary powers" in the Commission because of the "complicated nature of the problems" dealt with in the bill, and because the bill regulated a "field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means."[33] And the broad discretionary powers specifically granted the Commission over exchange rules were specifically characterized as "quasi-legislative."[34]

The floor debates on H.R. 9323 and S. 3420 focused on the nature and consequences of the broad power that these bills would, if enacted, grant the Commission over the exchanges' rules. In the House, concern centered around Section 19(b) of the Act (then Section 18(b), H.R. 9323) which empowered the Commission to act by rules in amending or altering the rules of an exchange, and the fact that the bill did not provide for direct appellate review of such Commission action.[35] In arguing that

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33/ H.R. Rep. No. 1383 at 6-7.

34/ 78 Cong. Rec. 8091 (remarks of Mr. Lea) (1934); see also 78 Cong. Rec. 7696 (remarks of Mr. Rayburn); 7862 (remarks of Mr. Lea) (1934).

35/ See 78 Cong. Rec. 8087-8093 (1934). In this connection an amendment in the House was offered by Representative Fish which would have required the Commission to act by order rather than through rulemaking in amending or supplementing an exchange's rules, and thus would have provided for appeal of such Commission action pursuant to Section 25(a) of the Exchange Act, 15 U.S.C. 78y(a). But this amendment was rejected. The Senate bill, S. 3420, did, however, require the Commission to act by order with respect to amending or supplementing an exchange's rules. As finally enacted, Section 19(b) of the Exchange Act provides that the Commission may act by rule or by order in altering, supplementing, or amending an exchange's rules. See H. R. Rep. 1838, 73d Cong., 2d Sess. 37 (1934) (Conference Report).

a procedure for judicial review of Commission action altering or amending exchange rules be provided, certain members of the House stressed, among other things, that the bill as drafted gave the Commission unreviewable authority to fix commission rates at levels which would put the exchange members out of business. 36/

During debate in the Senate the bill was criticized as granting the Commission authority over exchanges that exceeded that necessary to achieve what some Senators perceived as the bill's underlying purpose of curbing dishonest and economically harmful manipulative and speculative practices in connection with trading in securities. 37/ An amendment was offered by Senator Hastings of Delaware on the Senate floor to what is now Section 19(b) of the Exchange Act, that would have struck from that section of the bill the enumerated matters presently subject to the Commission's jurisdiction under Section 19(b), and instead would have limited the Commission

> "by order to alter or supplement the rules of [an exchange or all exchanges] insofar as it may be necessary or appropriate for the protection of investors or to insure fair dealings in the securities traded in upon such exchanges." 38/

36/ See 78 Cong. Rec. 8091 (remarks of Mr. Pettengill and Mr. Wadsworth); 8092 (remarks of Mr. Dondero) (1934).

37/ See 78 Cong. Rec. 8283 (remarks of Senator Walcott); 8591-92 (remarks of Senators Hastings and Copeland) (1934).

38/ 78 Cong. Rec. 8592 (1934).

Senator Hastings explained that while he favored giving the Commission authority to prevent "excessive credit for speculation and . . . unfair practices on stock exchanges," the section went too far in empowering the Commission "to regulate the internal operations of exchanges in many matters which do not bear, either directly or even remotely upon the control of credit or unfair practices in the purchase and sale of securities."[39] One of the matters of internal operations specifically pointed to was the fixing of commission rates.

In support of the Hastings amendment, Senator Copeland of New York argued that "the brokerage business is not a public utility" and therefore that it would be inappropriate to regulate the exchanges like a public utility through the fixing of commission rates.[40] Because of a "determination" in the Congress "to turn over the stock exchange and its whole operation to a commission of the Federal Government," Senator Hastings predicted that the amendment would not be adopted and, in fact, the amendment was rejected.[41]

39/ 78 Cong. Rec. 8592 (1934).

40/ Id.

41/ Id.

While various provisions of the legislation were modified in some respects prior to passage of the Act, [42] the basic regulatory scheme described above was enacted.

It is abundantly clear that the foregoing legislative history of the federal regulatory act involved in this case plainly refutes the essentially unsupported contention of the Antitrust Division (Div. Br. 23-29) that the Act was not intended to afford the Commission supervisory jurisdiction over the fixing of minimum commission rates by the exchanges, and therefore that this practice was left subject to other provisions of law, including the antitrust laws. Thus, while the Antitrust Division asserts (Div. Br. 21, 23) that Congress, as part of its goal of "preventing manipulation, deceptive practices, and excessive speculation" on exchanges intended "to protect investors from exhorbitant charges [and] not to prevent price competition among exchange members", there is no indication in the legislative history that the power granted to the Commission in Section 19(b)(9) to regulate the fixing "of reasonable rates of commission" was intended to be limited solely to setting maximum commission rates. Certainly, in view of the exchanges' practice of fixing minimum commission rates, dating back to 1792, an intention to exclude fixed minimum commissions from the Commission's supervisory jurisdiction would have been expressed in clear and unequivocal terms. Indeed, in rejecting the Hastings amendment, (see pp. 19-20, supra), Congress manifested its belief that the

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42/ See, e.g., H. R. Rep. 1838, 73d Cong., 2d Sess. 37 (1934) (Conference Report).

authority granted the Commission in Section 19(b) to alter or supplement exchange rules, where "such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange," was not limited to the prevention of fraudulent and manipulative practices on the exchanges. Moreover, the Antitrust Division's position, contrary to its claim (Div. Br. 24-25), finds no support in the statement of Samuel Untermeyer quoted, supra, at 13. To the contrary, the clear thrust of Mr. Untermeyer's recommendation was to provide the Commission with plenary authority in the area of fixing rates. The purpose of Mr. Untermeyer's recommendation is particularly evident when that recommendation is viewed in the context of his integral involvement in the Pujo Committee study and the conventional wisdom of the time that fixing minimum commission rates was a desirable practice. See n. 27, supra.

Finally, in an attempt to bolster its argument that the exchanges' practice of fixing minimum commission rates is beyond the scope of the Commission's supervisory jurisdiction, the Antitrust Division (Div. Br. 26-28) has referred to the 1938 Maloney Act Amendments to the Exchange Act as evidencing a federal policy against fixed minimum commission rates on exchanges since those amendments specifically prohibit the fixing of commissions by registered associations of over-the-counter securities dealers. See Section 15A(b)(8) of the Exchange Act, 15 U.S.C. 78oA(b)(8). But this argument ignores the critical distinction between the regulatory schemes.

The Maloney Act provided for self-regulation of the over-the-counter market through the establishment of associations of over-the-counter market dealers -- associations yet to be created when the Act was passed. In creating this regulatory scheme, Congress recognized that self-regulatory associations in the over-the-counter market could have an anti-competitive effect on the then existing "free and open" nature of that market. H. R. Rep. No. 2307, 75th Cong., 3d Sess. 8 (1938). In contrast to the over-the-counter market, the proponents of the Maloney Act noted that the exchanges "had certain features that may be regarded as monopolistic because of their exclusive nature," and explained that the Exchange Act represented "an attempt to bring those practices under control" Hearings Before the Senate Committee on Banking and Currency on S. 3255, 75th Cong., 3d Sess. 7 (1938). Since the over-the-counter market lacked any monopolistic aspects, Congress made clear in the Maloney Act that the activities of registered associations were "to be consistent with the operation of free and open markets." H. R. Rep. No. 2307, 75th Cong., 3d Sess. 8 (1938). Accordingly, while Section 15A(b)(8) is obviously relevant to the propriety of rate fixing in the over-the-counter market, its only relevancy to exchange rate fixing is to point up the marked difference between the two markets and to emphasize that in regulating the stock exchanges Congress recognized that it was dealing with monopolistic entities and not a free and open market, and thus sought to bring the anticompetitive aspect of fixed minimum commissions within the supervisory jurisdiction of the Commission.

B. The Statutory Framework Implementing the Regulatory Scheme.

As we have now shown, the Exchange Act was designed to establish a regulatory scheme both for providing vigorous and effective self-

regulation by the exchanges of their operations and their members' conduct and for quasi-legislative supervisory control by the Commission over the important aspects of a securities exchange's internal operations, including the fixing of minimum commission rates by the exchange. To implement this scheme Congress provided first, in Section 6 of the Act, 15 U.S.C. 78f, for the registration of securities exchanges with the Commission. 43/ Section 6(a), 15 U.S.C. 78f(a), provides, as a prerequisite to registration, that the registration statement filed by the exchange contain, inter alia, "[a]n agreement . . . to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of" the Exchange Act and the Commission's rules and regulations thereunder, and also "[a]n agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption." Furthermore, under Section 6(d), 15 U.S.C. 78f(d), the Commission, before granting an application for registration, must find that an exchange is "so organized as to be able to comply with the provisions of" the Act and that its rules "are just and adequate to insure fair dealing and to protect investors."

43/ Section 5 of the Act, 15 U.S.C. 78e, makes it unlawful, except in certain cases not relevant here, to effect any securities transaction on an unregistered exchange.

Congress next provided, through Section 19(a) of the Act, 15 U.S.C. 78s(a), that the Commission be vested with jurisdiction to assure compliance by registered exchanges with their self-regulatory duties under the Act. Section 19(a)(1), 15 U.S.C. 78s(a)(1), authorizes the Commission to discipline an exchange within specified limits for violating the Act or any rules thereunder, or for failing "to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon."[44/] And pursuant to Section 19(a)(2), 15 U.S.C. 78s(a)(2), the Commission may discipline members and officers of registered exchanges.

Finally, and most important, in Section 19(b) of the Act Congress conferred quasi-legislative powers upon the Commission to supervise and oversee the nature and structure of particular exchanges and exchanges generally. Under Section 19(b), if the Commission, after following prescribed procedures, determines that changes in an exchange's rules are

> "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange [may] by rules or regulations or by order . . . alter or supplement the rules of such exchange"

44/ The Commission has, pursuant to Section 19(a)(1), withdrawn the registration of a national securities exchange which, among other things, violated the Exchange Act and failed to enforce compliance with the Act and with the exchange's own rules by members and issuers of listed securities. San Francisco Mining Exchange, Securities Exchange Act Release No. 7870 (1966), [1966-1967 Transfer Binder] CCH Fed. Sec. L. Rep. ¶77,343, affirmed, sub. nom. San Francisco Mining Exchange v. Securities and Exchange, 278 F. 2d 162 (C.A. 9, 1967).

with respect to twelve broadly enumerated subjects and "similar matters."[45/] One of the matters specifically enumerated -- in Section 19(b)(9) -- is "the fixing of reasonable rates of commission . . ." by the exchanges.

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Section 19(b) provides:

> "The Commission is . . . authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters."

(footnote continued)

It can thus be seen that, from the very initial stage of registration of an exchange with the Commission, the necessity and propriety of exchange rules fixing commission rates are matters delegated to the Commission's quasi-legislative jurisdiction. And while

> "the promulgation of rules concerning exchange-required fixed commission rates is a matter that Congress entrusted to the exchanges in the first instance,"46/

any exchange's action affecting its commission rate structure is also a matter which must comport with the Commission's policy. Section 19(b) prescribes certain procedures to be followed with respect to changes in

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(footnote continued)

> In recognition that its authority to regulate the rules of registered securities exchanges would be fostered by affording "an opportunity for orderly Commission consideration of exchange rules before they become effective," the Commission in 1964 promulgated Rule 17a-8 , 17 CFR 240.17a-8, pursuant to Section 17(a) of the Exchange Act, 15 U.S.C. 78q(a), which requires regulated entities to file reports. See Securities Exchange Act Release No. 7253 (1964). The Rule requires an exchange to file with the Commission "copies of . . . any proposed amendment or repeal of, or any addition to, its rules not less than three weeks . . . before any action is taken [by the exchange to adopt] . . . such amendment."

46/ Securities Exchange Act Release No. 10560 (1973) [CCH Fed. Sec. L. Rep. ¶79,603 at p. 83,620].

exchange rules relating to rates of commission, which have been aptly summarized as follows:

> "The first step is that an exchange adopts rules fixing rates of commission. If changes are deemed necessary or appropriate, the Commission is to present an appropriate request in writing for specified changes. Compliance by the exchange presumably ends the matter, but if the exchange does not accede, the Commission is empowered, after appropriate notice and opportunity for hearing, 'by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) . . .'" 47/

This scheme of supervised self-regulation in the Exchange Act is the "frame of reference within which the Commission operates; and the policies expressed in [that Act] must be the basic determinants of its action." 48/ Consequently, while the Commission has long recognized that the effect on competition is a highly relevant factor in determining

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47/ Securities and Exchange Commission, Special Study of Securities Markets, Pt. 2 , p. 344 (1963).

48/ McLean Trucking Co. v. United States, 321 U.S. 67, 79-80, 85-88 (1944) (Interstate Commerce Commission). Cf., California Gas Producers Association v. Federal Power Commission, 421 F. 2d 422, 428-29 (C.A. 9), certiorari denied, 400 U.S. 819 (1970); Cities of Statesville v. Atomic Energy Commission, 441 F. 2d 962, 987 (C.A.D.C., 1969) (Leventhal J., concurring); Northern Natural Gas Co. v. Federal Power Commission, 399 F. 2d 953, 961 (C.A.D.C., 1968). The legislative history of the Exchange Act suggests that Congress intended that the Commission, in exercising its Section 19(b) authority over exchanges, look to the policies of the Act generally for a standard. See 78 Cong. Rec. 8091 (Remarks of Mr. Lea) (1934).

whether rules of an exchange are "necessary or appropriate,"[49/] competition is not the only factor which must guide the Commission in the exercise of its quasi-legislative jurisdiction over the exchange markets. Under the public interest standard implicit in Section 19(b), the Commission must also be concerned with such questions as the liquidity of the exchange market, the financial health of the brokerage industry, the ability of the brokerage industry to raise capital, and the ability of the brokerage industry to provide efficient and effective service to investors.[50/] The very pattern of the Exchange Act, as well as practical considerations, require the Commission to rely substantially on exchange self-regulation to protect these concerns. Thus, to the extent that changes in an exchange's rules, including modification in the commission rate structure of an exchange, may affect the ability of the exchange to regulate, the Commission must weigh the continued viability of the exchanges as effective regulatory institutions against a policy considering competition alone.

49/ See In the Matter of the Rules of the New York Stock Exchange, 10 SEC 270, 287 (1941); Securities Act Release No. 8239 (January 26, 1968). Securities Exchange Act Release No. 9950 at pp. 169-70 (January 26, 1973) [185 BNA Sec. Reg. and Law Rep. (January 17, 1973)]. The public interest standard implicit in Section 19(b) would seem to require that the Commission consider competitive factors in applying that standard. Gulf States Utilities v. Federal Power Commission, 411 U.S. 747 (1973); Federal Maritime Commission v. Seatrain Lines, Inc., 411 U.S. 726 (1973).

50/ Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, on S. 3169 92d Cong., 2d Sess. 8, 11, 14 (March 22, 1972) (Testimony of William J. Casey, Chairman, Securities and Exchange Commission).

II. THE STATUTORY SCHEME OF SUPERVISED SELF-REGULATION EMBODIED IN THE EXCHANGE ACT PRE-EMPTS THE APPLICATION OF THE ANTITRUST LAWS TO THOSE EXCHANGE PRACTICES THAT ARE SUBJECT TO THE QUASI-LEGISLATIVE JURISDICTION OF THE COMMISSION.

A. The Silver and Ware Decisions.

Having examined the genesis and aims of the statutory scheme of supervised self-regulation embodied in the Securities Exchange Act, and having demonstrated that the fixing of minimum commission rates is within the scope of exchange self-regulation subject to the Commission's quasi-legislative authority, it is now appropriate to consider "the principles of stock exchange pre-emption delineated" [51/] by the Supreme Court in Silver v. New York Stock Exchange, Inc., 373 U.S. 341 (1963) and Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 94 S. Ct. 383 (1973).

In Silver, the petitioners, who were not members of the NYSE, brought an action under the Sherman Act alleging that the NYSE "conspired with its member firms to deprive petitioners of their private wire connections and stock ticker service" provided to them by members of the NYSE. Id. at 345. The Supreme Court initially noted that since the NYSE's action, in causing member firms to disconnect petitioners' wire connections and stock ticker, constituted a group boycott, "absent any justification derived from the policy of another statute or otherwise, the Exchange acted in violation of the Sherman Act." Id. at 347-349.

51/ Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, supra, 94 S. Ct. at 384.

Because the NYSE's action had been taken under color of enforcing "its rules governing members' transactions and relationships with non-members," and was thus "germane to performance of . . . [its] duty" of self-regulation embodied in the Exchange Act (Id. at 356), the existence of a prima facie violation of the antitrust laws was found by the Court to be only "the beginning, not the end, of inquiry." Id. at 349. For, as the Court stated, the "antitrust aim of eliminating restraints on competition" must be reconciled "with the effective operation of a public policy [embodied in the Exchange Act] contemplating that securities exchanges will engage in self-regulation which may well have anti-competitive effects in general and in specific applications." Id.

In effecting this reconciliation between the public policy of the Securities Exchange Act and the aims of the antitrust laws, the Supreme Court enunciated the "guiding principle" that, since the Exchange Act "contains no express exemption of the antitrust laws," and since "'[i]t is a cardinal principle of construction that repeals by implication are not favored,'" an implied repeal would be found "only if necessary to make the Securities Exchange Act work." Id. at 357. The Court then distinguished between two aspects of the self-regulatory scheme embodied in the Exchange Act: those self-regulatory activities of registered exchanges over which the Commission has jurisdiction; and those self-regulatory activities not within the Commission's authority. Id. In this regard, the Court observed that while the Commission has jurisdiction "to request

exchanges to make changes in their rules" and "to disapprove any rules adopted by an exchange," it does not have jurisdiction "to review particular instances of enforcement of exchange rules." 373 U.S. at 357. Accordingly, the particular exchange action before the Silver Court, involving enforcement of particular exchange rules, was not subject to the Commission's jurisdiction and therefore the question of reconciliation in that case did "not involve any problem of conflict or coextensiveness of coverage with the agency's regulatory power." Id. at 358.

The Court further observed that the Exchange Act contains no "form of review of exchange self-policing" of its rules and therefore "[t]here is nothing built into the regulatory scheme which performs the antitrust function of insuring that an exchange will not in some cases apply its rules so as to do injury to competition which cannot be justified as furthering legitimate self-regulative ends." Id. at 358-359. Furthermore, the Court reasoned, application of the antitrust laws to particular instances of exchange enforcement of exchange rules was "not at all incompatible with the fulfillment of the aims of the Securities Exchange Act," since "under the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the exchange sufficient breathing space within which to carry out the mandate" of the Act. Id. at 359-360. The Supreme Court stated:

> "Application of the antitrust laws, therefore, [rested in Silver] on the need for vindication of their positive aim of insuring competitive freedom. Denial of their applicability [to the Silver facts] would defeat the Congressional policy reflected in the antitrust laws without serving the policy of the

> Securities Exchange Act. Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented."

Id. at 360 (emphasis added). 52/

In Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, supra, 94 S. Ct. at 383, the Supreme Court recently reaffirmed and elaborated upon the principles of stock exchange pre-emption expressed in Silver. In Ware, the Court considered whether an NYSE rule requiring arbitration of controversies arising out of the termination by an individual of his employment with an exchange member pre-empted California state law which afforded an employee the right to litigate wage disputes arising out of his employment. In its analysis, the Court stressed that the Exchange Act established a scheme of supervised self-regulation in which the Commission is provided with authority over exchange regulation and exchange rules relating to "12 designated subject areas and 'similar' matters" enumerated in Section 19(b). 53/ "As a consequence, some exchange rules [i.e., those

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52/ The Supreme Court finally concluded that the manner in which the NYSE and its members acted to disconnect the wire connections and stock ticker service to petitioners deprived the petitioners of such basic procedural safeguards that "the Exchange [had] . . . not even reached the threshold of justification under [the Exchange Act]. . . for what would otherwise be an antitrust violation." The court therefore sustained the petitioners' antitrust challenge. 373 U.S at 361-365.

53/ In addition to its Section 19(b) authority, the Ware Court also noted that the Commission is given rulemaking authority in a number of other sections of the Act to promulgate rules which will affect the conduct of exchange members. 94 S. Ct. at 391 n. 10. See Sections 8, 9, 10, 11, 14 and 17 of the Exchange Act, 15 U.S.C. 78h, 78i, 78j, 78k, 78n and 78q.

not within the scope of Section 19(b)] are not subject to direct Commission scrutiny." 94 S. Ct. at 391. And such an exchange rule which is not within the scope of Section 19(b), the Court reasoned, "would not appear to fall under the shadow of the federal umbrella [of stock exchange pre-emption]; it is instead, subject to applicable state law." Id. 54/

It is apparent that neither Silver nor Ware involved the issue presented here. Unlike the case at bar, where the challenged self-regulatory conduct--the fixing of minimum rates of commission--is directly within the scope of the Commission's regulatory authority under Section 19(b), the self-regulatory conduct at issue in both Silver and Ware was not subject to the supervisory jurisdiction of the Commission. Therefore, Silver provides no support for the proposition advanced by the Antitrust Division (Div. Br. 11) that even though a particular rule of a stock exchange is subject to the Commission's quasi-legislative jurisdiction, it is nevertheless not exempted from the antitrust laws unless it is shown to be "necessary to make the Securities Exchange Act work." 55/ Indeed, the Supreme Court in Silver expressly

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54/ Since the Court found that none of the subject matter categories of Section 19(b) suggests "that the Commission has review authority with respect to a rule requiring arbitration of employer-employee disputes" (94 S. Ct. at 393, n. 14), and since it determined that the relationship between compulsory employer-employee arbitration and the policies enumerated in Section 19(b) is "'extremely attenuated and peripheral, if it exists at all,'" the Court held that the exchange's arbitration rule did "not require pre-emption of contrary state law." Id. at 394.

55/ In support of its claim "that the Court intended the Silver reconciliation standard to be applied to exchange rules which are subject to SEC review" (Div. Br. 11), the Antitrust Division relies upon a statement in the Silver decision to the effect that Commission rules affecting securities exchanges must be "consonant with the antitrust laws" 373 U.S. at 364, n. 16. We fail to see how this requirement as to Commission rules has any bearing on the appropriate reconciliation of an exchange rule with the antitrust laws. Furthermore, since a Commission rule

(footnote continued)

stated that "[s]hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented." 373 U.S. at 360. 56/

B. Application of the Antitrust Laws to this Case Would Be Repugnant to the Regulatory Scheme Established in the Exchange Act.

1. The "Plain Repugnancy"

In the previous section of this brief we have demonstrated that this is the "different case" referred to in Silver, and that prior Supreme Court precedents do not suggest that the "necessary to make the Act work" standard is to be applied in reconciling the antitrust laws with particular exchange rules which are subject to the Commission's quasi-legislative jurisdiction. We submit that reconciliation of the antitrust laws with the regulatory scheme established in the Exchange Act, requires that where exchange rules are clearly subject to the Commission's quasi-legilative jurisdiction, the antitrust laws must be found to be inapplicable. 57/

(footnote continued)

under Section 19(b) is "consonant with the antitrust laws" where the Commission has accorded appropriate weight to competitive factors in formulating that rule (see cases cited n. 48, supra), there is nothing in the Supreme Court's statement that suggests that an exchange rule, if subject to the Commission's jurisdiction, must be shown to be necessary to make the Exchange Act work in order to be consonant with the antitrust laws.

56/ The Silver Court suggested that an example of such a different case would be the Commission's jurisdiction "under the 1938 Maloney Act amendments to the Exchange Act to examine disciplinary action by a registered securities association." 373 U.S. at 358.

57/ See Kaplan v. Lehman Brothers, 250 F. Supp. 562 (N.D. Ill., 1966), affirmed, 371 F 2d 409 (C.A. 7, 1967), certiorari denied, 389 U.S. 954 (1967).

This pre-emption of the antitrust laws is necessary because their application would be in derogation of the regulatory scheme of the Exchange Act.[58/] In short, in order to make this portion of the Exchange Act (where the Commission has specific regulatory jurisdiction) work, it is necessary to pre-empt the antitrust laws.

The regulatory scheme established in the Exchange Act was designed to provide regulation in an area where "the complicated nature of the problems justified leaving much greater latitude of discretion with the administrative agencies than would otherwise be the case"; "a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means." H. R. Rep. No. 1383 at 6-7. Congress thus felt justified in vesting to the Commission, "within constitutional limitations, that measure of flexibility required in dealing with so intricate a subject matter" (id.), and accordingly granted the Commission "broad discretionary powers" (id.)--powers to investigate the operation of the exchange market, to review existing exchange rules and to initiate prospective rules of general or particular application. This authority to formulate policy for the securities industry, and thereby in effect to legislate, cannot be exercised

> "in a cursory or incomplete manner or without having extensive hearings and examinations into the subject matter, and without permitting those interested, representing the public and groups in the securities industry an opportunity for a full expression of views."

Stark v. New York Stock Exchange, Inc., 346 F. Supp. 217, 227 (S.D.N.Y.), affirmed per curiam, 406 F. 2d 743 (C.A. 2, 1972).

58/ Haddad v. Crosby Corp., CCH Fed. Sec. L. Rep. ¶94,319 (D. D.C., 1973), appeal docketed May 7, 1974 (U.S.).

Yet, if district courts possesed jurisdiction under the antitrust laws over exchange operations concurrent with that of the Commission as both plaintiff and the Antitrust Division assert (G. Br. 6; Div. Br. 2-3), the structure of the exchanges would necessarily be determined, at least in part, by a decision making entity which does not have the requisite capacity to engage in quasi-legislative regulation of exchanges. For enforcement of the antitrust laws involves no question of regulatory policy but merely application of existing standards to adduced facts.[59/] A district court, "acting on a single, isolated case-and-controversy record in a private suit" is simply not equipped to consider the broad economic policies involved--the inter-relationship of a particular rule to the structure of the regulated industry, and the implications of abandoning that rule.[60/]

Moreover, were a district court to apply the "necessary to make the Act work" standard to exchange rules subject to Commission jurisdiction in the manner intended by Silver to operate with respect to exchange conduct outside the scope of Commission authority, as the plaintiff and the Antitrust Division urge (G. Br. 6; Div. Br. 3), the very purposes of Congress in vesting the Commission with quasi-legislative authority would be frustrated. What is necessary to make the Act work today may be unnecessary or even counter-productive tomorrow.

59/ "[T]he judicial function is traditionally to weigh the merits of a particular controversy, but not to engage in a consistent determination of policy or to maintain steady contact with a general and continuing problem." Walter Gellhorn, "The Administrative Agency--A Threat to Democracy?" at 517 in Separation of Powers and the Independent Agencies: Cases and Selected Readings, prepared for the Subcommittee on the Judiciary of the Senate Committee on the Judiciary, 91st Cong., S. Doc. No. 91-49.

60/ Cf., Port of Boston Marine Terminal Ass'n v. Rederiaktiabolaget Transatlantic, 400 U.S. 62, 69 (1970).

A period of experimentation may be required in order to resolve whether an exchange's rules are appropriate for present purposes,[61/] even though there may be no present answer to the question of appropriateness in the long run.

It is the Commission's contention that the inability of the district courts to perform the quasi-legislative regulatory function which Congress intended to impose over exchange operations, requires the conclusion that application of the antitrust laws to exchange rules specifically subject to the Commission's jurisdiction would be repugnant to the Exchange Act. "[T]o make the Securities Exchange Act work . . . .," it is basic that the Commission be able to perform the policy-making functions expressly assigned to it by that Act, in the application of standards set forth in that Act, in the manner prescribed by that Act. The Exchange Act cannot be expected to work as Congress intended if district courts may render ad hoc decisions applying antitrust standards to matters involving the very structure of the securities industry and thereby pre-empt the Commission's policy-making functions. Because of this "plain repugnancy between the antitrust and regulatory provisions," the antitrust laws must be held to be impliedly repealed with respect to matters within the Commission's quasi-legislative

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61/ Cf., Delta Air Lines v. Civil Aeronautics Board, 455 F. 2d 1345 (C.A. D.C., 1971).

jurisdiction under the Act, [62/] and in particular with respect to the commission rate structure.

Furthermore, as the Supreme Court observed in Silver, supra, 373 U.S. at 352, Congress intended through the Exchange Act to leave with the exchanges "the initiative and responsibility for promulgating regulations pertaining to the administration of their affairs" subject, of course, to Commission supervision. S. Rep. No. 792, 73d Cong., 2d Sess. 13 (1934). If an exchange were exposed to the specter of treble damages for its adoption of rules contemplated by the Exchange Act, this fundamental element of the scheme of supervised self-regulation would be abrogated. Since any meaningful exercise of self-regulation will likely have anti-competitive implications, the exchanges could be expected, contrary to the congressional intent, to abdicate all but the most innocuous of their self-regulatory responsibilities--and leave all initiative to the Commission--if they were faced with a risk of substantial antitrust liability for doing that which the Act contemplates.

62/ We recognize that the Court of Appeals for the Seventh Circuit, in Thill v. New York Stock Exchange, Inc., 433 F. 2d 264, 273, certiorari denied, 401 U.S. 994 (1971) has held with respect to an antitrust challenge to the NYSE's fixed commission rate system and former antirebate rule (which was intended to preserve the integrity of that system by forbidding an exchange member from rebating to his customer or to a non-member broker any portion of the fixed rate) that

> "before a court may abdicate its jurisdiction on the antitrust issue the defendant must establish its anticompetitive conduct as justified because it is necessary for the operation of the Securities Act [sic]."

We think that Thill is distinguishable in that the plaintiff there alleged not only that the NYSE's fixed rate system and anti-rebate were anti-competitive but also that the NYSE was discriminatorily enforcing the anti-rebate rule. We are of the view, however, that Thill was wrongly decided when it concluded that every rule of the NYSE whether or not subject to the Commission's jurisdiction must be justified as necessary to make the Act work before it is immune from the antitrust laws.

2. The Public Record of Commission Supervision Over the Exchanges' Commission Rate Structure Illustrates the Necessity of Leaving Such Matters Solely to the Quasi-Legislative Jurisdiction of the Commission Rather Than to Review by an Antitrust Court

Since the basic aims of the regulatory scheme embodied in the Exchange Act are inimical to and would be frustrated by the application of the antitrust laws to exchange rules concerning the fixing of minimum commission rates as well as to all other exchange practices that are within the scope of the Commission's quasi-legislative jurisdiction, such exchange conduct must be considered to be immune from antitrust attack even where the Commission has not exercised its jurisdiction. Nevertheless, the Commission has, in fact, been exercising its quasi-legislative mandate over the commission rate structure of the exchanges. The public record of Commission action in this area, both illustrates the complex and subtle economic issues posed in formulating policy with respect to the rate system, and substantiates the necessity for leaving exchange self-regulatory conduct with respect to matters which Congress brought within the scope of the Commission's quasi-legislative authority, to the exclusive jurisdiction of the Commission instead of to the ad hoc jurisdiction of antitrust courts.

The respective fixed commission rate structures of the NSYE and the AMEX were approved by the Commission in 1934 when the Commission granted the applications of those exchanges for registration as "national securities exchanges" pursuant to Section 6 of the Exchange Act. (39a-40a, 179a, 193a-202a). Thereafter, the defendant exchanges amended their rules respecting commission rates from time to time, submitting copies of these amendments to the Commission upon their adoption in accordance with Section 6(a) of the Act (41a, 181a-182a).

In 1963, pursuant to congressional mandate, 15 U.S.C. 78s(d), the Commission published a six-volume Special Study of Securities Markets, H.R. Doc. 95, 88th Cong. (1963) ("Special Study"), which contained the results of a detailed investigation by the Commission's staff of the operation of the securities industry. Commencing in 1964, the Commission's staff and the exchanges initiated discussions to implement the recommendations of the Special Study (42a-43a, 183a-185a). Then, in 1968, in order to examine fully certain practices pertaining to fixed stock-exchange-commission rates, the Commission held investigatory hearings, pursuant to Section 21(a) of the Exchange Act, 15 U.S.C. 78u(a), 63/ on the commission rate structure of securities exchanges and the securities industry (74a, 229a-233a). 64/ Again,

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63/ Section 21(a) of the Exchange Act, authorizes the Commission "in its discretion, . . . to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid . . . in the prescribing of rules and regulations . . . [under the Exchange Act], or in securing information to serve as a basis for recommending further legislation concerning the matters to which this title relates."

64/ The Commission announced the commencement of these hearings on May 28, 1968. See Securities Exchange Act Release No. 8324 (1968) (231a-233a). These hearings, which were conducted through the summer of 1971, were intended to elicit information on, among other things, how the securities industry worked and whether "a minimum exchange commission rate structure is necessary" to the operation of the securities industry. Id.

commencing on October 12, 1971, also pursuant to Section 21(a) of the Exchange Act, the Commission held further public hearings on the structure of the securities markets. Interested persons appeared and presented their views with respect to various interrelated matters concerning the appropriateness of modifications to the structure of the securities markets. 65/ Upon conclusion of these hearings, and following publication of a second congressionally-mandated study of

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65/ In Securities Exchange Act Release No. 9315 (August 26, 1971) the Commission announced that the following matters were to be considered during the hearings:

"(1) The desirability, structure and means of developing a national system of securities exchanges and the relationship of such a system to other securities markets;

"(2) So-called 'institutional membership' on exchanges including (i) exchange membership by financial institutions (such as insurance companies, trust companies foundations, investment companies and pension funds); (ii) exchange membership by affiliates of financial institutions such as their investment advisers, managers, parents, subsidiaries or other affiliates, who may utilize such memberships either to execute portfolio transactions for an institutional affiliate or in one way or another to facilitate the recapture of commissions by an institution or to conduct a general securities business as an exchange member, or any combination of the foregoing; (iii) exchange membership by other organizations whose primary business may not be that of a broker or dealer of their affiliates; (iv) whether and the conditions under which any of the foregoing persons should be permitted to engage in the business of a broker or dealer in securities (aside from acting as underwriters for the shares of one or more investment companies);

"(3) Restrictions on access of non-members to exchange markets and of exchange members to the third markets;

"(4) The reasons for differing regulation of securities markets and the kind of additional or modified regulation, if any, which may be needed;

"(5) The need for additional disclosure of information on prices, volume and quotations in all markets, and the nature thereof through a composite tape or otherwise, and

"(6) Competition among exchanges and between exchanges and other markets."

the securities markets by the Commission--The Institutional Investor Study, H. R. Doc. No. 92-64, 92d Cong., 1st Sess. (1971)--the Commission issued a Statement on the Future Structure of the Securities Markets (February 2, 1972) ("Policy Statement"), in which the Commission enunciated its commitment to the creation of a central market system in listed securities (286a).

In the Policy Statement, the Commission noted that one of the major barriers to the central market system is fixed minimum brokerage commissions. Policy Statement at 15 (299a).[66/] Nevertheless, the Commission observed that "we are dealing with an industry which has operated under fixed commission rates for a very long time." Id. Consequently, while the Commission expected that the goals of "competitive rates and the creation of a centralized market system" would have desirable incidents, it was at the same time concerned that competitive rates might result in

> "deterioration in standards of service and responsibility or . . . higher transaction costs owing to increased spreads and fluctuations, or [the possibility that] . . . investment managers [will make] . . . visible commission cost an exclusive criterion in deciding where to place their executions and [thus ignore] . . . through carelessness or fear of criticism, the elements of skill, knowledge, judgment and advice."

Id. at 14 (298a).

66/ The Commission observed that fixed minimums may not only have been at an unreasonable level, but also may have caused the serious side effects of

> "(a) Dispersion of trading in listed securities
> (b) Reciprocal practices of various kinds.
> (c) Increasing pressure for exchange membership by institutions."

Policy Statement at 15 (299a). These side effects, the Commission stated, were obstacles to the central market system in that they cause

> "certain markets and market makers . . . to choose to stay outside the system in order to compete in service charges as well as in execution, as the third market does, or in order to compete, as certain regional exchanges do, for institutional business by directly or indirectly providing institutions with rebates of commissions." Id.

In the Commission's view, "[a]ny changes in the commission structure should not reverse" the ongoing process of upgrading broker-dealer "standards of service to the public including the provision of adequate information, advice, care, and responsibility." Id. at 15-16 (299-300a). Thus, the Commission concluded that "[i]t is necessary to measure the effect of competitively determined commissions very carefully on a step-by-step basis." Id. at 15 (299a). While "[t]he principal argument in favor [o]f fixed minimum commissions is the severe decline in the revenue of the securities industry predicted to result if competitive rates were suddenly introduced on all institutional business," it was the Commission's opinion that the industry should be able to adjust to the introduction of competitive rates, "at least on large orders, at a measured deliberate pace." Id. at 16 (300a). 67/

67/ The Commission's letter, transmitting the Institutional Investor Study to the Congress, stated:

> "We have . . . taken initial steps to require competitive rates . . . which we believe will have ameliorating effects on future developments in a number of the areas studied. Assuming that the step called for is timely implemented by the . . . [NYSE], the Commission's subsequent steps in this and related areas must necessarily be guided to a considerable extent by its experience with the initial step. . . . In this situation we believe the sound regulatory course is to proceed with caution on any further concrete recommendations concerning the structure of the securities markets." (footnote omitted).

Securities and Exchange Commission, Institutional Investor Study, H. R. Doc. No. 92-64, 92d Cong., 1st Sess., Pt. 1, at vii-viii (1971).

The Commission's approach has been endorsed in Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess., Securities Industry Study, at p. 60 (Comm. Print, 1972), in Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess., Securities Industry Study, at p. 62. (Comm. Print, 1973), and in United States Department of Treasury, Public Policy for American Capital Markets 6 (1974).

These views reflected a reaffirmation of conclusions that the Commission had earlier reached "that fixed minimum commissions on institutional size orders are neither necessary nor appropriate" (279a, 281a).[68/] Thus, on October 22, 1970, the Commission had taken a position in a letter to the NYSE that fixed minimum commission rates "for that portion of orders in excess of $100,000" were unreasonable. Securities Exchange Act Release No. 9007 (1970) (276a).[69/] The Commission

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68/ The Commission's reservations concerning the exchanges' fixed minimum commission rate system as it related to large trades dates back to the Special Study of 1963. See Special Study at 328-351. In the Special Study it was noted that since the commission rate structure of the exchanges allowed no discount for large volume trades, although the cost per share to the broker effecting such transactions was significantly less than for smaller volume trades, certain practices occurred. Id. Among these was the practice of executing large trades off the exchanges in order to take advantage of discounts derived from the economies of size and the practice by exchange members of making unauthorized reciprocal payments at the direction of persons who channeled the exchange member large trades. Id. See also 183a.

For a period after the Special Study, the Commission's staff and representatives of the exchange met to discuss implementing the recommendations of the Special Study that these practices be curbed. (42a-43a, 183a-185a). Then, in 1968, the Commission took direct steps to relieve the problems by requesting the exchanges to integrate into their commission rate system a volume discount or alternatively to eliminate minimum commissions on portions of orders above $50,000.

69/ The Commission's conclusion that it was unreasonable for securities exchanges to prescribe fixed rates on portions of orders above $100,000 was conveyed to the exchanges as part of a letter to the NYSE. This letter was intended to advise the NYSE of those aspects of a new increased commission rate schedule prepared by the NYSE which the Commission found not to be reasonable. The NYSE's new schedule originated as an interim surcharge that

(footnote continued)

later determined "not [to] object to the . . . [NYSE] commencing competitive rates on portions of orders above a level not higher than $500,000 rather than the $100,000 figure . . .," but insisted that this be done by April 10, 1971 (279a). Most exchanges had implemented competitive commission rates above that level by April 5, 1971. Securities Exchange Act Release No. 9148 (April 14, 1971).

Thereafter, the Commission observed the effect of negotiated rates above $500,000.[70/] Having done so, the Commission concluded in its

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(footnote continued)

the NYSE sought to place on small orders in order to compensate for severe financial conditions which its members suffered in 1969-1970 (187a-188a).

70/ In its letter of October 22, 1970 to the NYSE (see p. 45 supra) the Commission had requested the exchange to submit no later than June 30, 1971, a "new rate schedule of scaled percentage charges based upon the amount involved in an order" (279a). On April 14, 1971, the Commission informed the securities industry that any further reduction of the negotiated rate breakpoint would be deferred pending the submission expected from the NYSE on June 30, 1971. Securities Exchange Act Release No. 9148 (April 14, 1971). The Commission intended:

> "to observe the workings of competitive commission rates on orders in excess of $500,000 to consider carefully all questions which arise as a result thereof."

Id.

In September 1971, after receipt and analysis of the submissions and the public comments thereon, the Commission announced that it was not disposed at that time to lower further the breakpoint to a level below $500,000, but would continue to

> "study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000."

(footnote continued)

February 1972 Policy Statement that while

> "further reductions in the breakpoint [i.e., the transaction size above which rates must be negotiated] might have a more severe impact on the income of certain kinds of member firms, on the services they provide, on their role in the capital markets, including the distribution of securities, and on the desires of institutions and their managers to recapture commissions or otherwise use them for their benefit."

it would nevertheless be appropriate for a $300,000 breakpoint to take effect in April of 1972. Policy Statement at 16 (300a).

On May 31, 1973, in response to severe financial conditions in the securities brokerage industry, the NYSE submitted to the Commission proposed amendments to its constitution and rules which would result in an increase in the commissions charged by NYSE members. (Doc. App. 30). Shortly thereafter--on June 6, 1973--the Commission commenced "a public investigatory hearing . . . to consider whether any changes should be made in the rules, policies, practices and procedures of one or more registered national securities exchanges respecting commission rate schedules" (Doc. App. 30). On September 11, 1973, the Commission

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(footnote continued)

> Securities Exchange Act Release No. 9351 (September 24, 1971). The Commission advised the NYSE that since "a rule dealing with commission rates is necessarily dependent for its validity upon the continuation of the conditions and circumstances justifying the reasonableness of the rates" the NYSE should continue to "review its commission rate structure," "gather necessary data from its members" and submit any modifications or changes in its commission rate structure to the Commission "to enable [the Commission] to exercise its continuing regulatory oversight." Id.

publicly announced its "conclusions concerning the commission rate proposals of the . . . [NYSE] . . . ." The Commission concluded that it would not object if the NYSE should immediately adopt its proposed commission rate increases, effective through March 31, 1974. The Commission further concluded that it would not object to the continuation of those increases from April 1, 1974, through April 30, 1975, subject to the condition that the NYSE first adopt certain other rules to become effective by or before April 1, 1974.[71/] The Commission stated in its announcement, however, that "it will act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the stock exchanges do not adopt rule changes achieving that result." The Commission further concluded that it would "not initiate in April 1974, a breakpoint reduction below $300,000 respecting the portion of orders above which rates may be competitively determined," (Doc. App. 32).

Subsequently, in a letter from the Commission to the NYSE, dated December 14, 1973, (Doc. App. 34) the Commission explained that in view of the fact that in the Exchange Act "rules concerning exchange-required fixed commission rates [are matters] that Congress entrusted to the exchanges in the first instance, at least as long as the fixing of commission rates should be permitted, and that after considering a number of factors, it "could not conclude that the NYSE's rate proposal was unreasonable" (Doc. App. 35). Accordingly, the Commission was "motivated . . . to raise no objection to the NYSE's rate increase for the period ending March 31, 1974." (Doc. App. 36).

71/ Specifically, the Commission's conclusion not to object to the continuation of the increase after April 1, was conditioned upon the adoption of rules to "(a) eliminate that portion of NYSE Rule 393 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedules, and (b) permit, but do not require, member firms to provide less than a full range of brokerage services presently furnished customers in return for a discount of up to 10 percent from the commission rate schedule . . . [that had been proposed by the NYSE]" (Doc. App. 37).

This conclusion would, of course, be obviated were the exchange to determine not to continue the increased commission rates after April 1, 1974.

The Commission also explained that its

> "conclusion that it would be appropriate to require exchanges to eliminate fixed rates effective by April 30, 1975, of course, also had some influence on its conclusion not to object to the specific rate proposed by the NYSE."

(Doc. App. 37). Thus, the Commission reasserted that

> "the long history of fixed rates argues against a precipitous elimination of the fixed rate system. It is appropriate, for the protection of investors and in the public interest, that stock exchange firms be given an opportunity to develop business strategies and adjust their operations to a competitive-rate environment. It is not appropriate to risk the possibility that undue haste might threaten the ability of the industry to fulfill its essential function of serving the needs of investors and corporations seeking capital from the public. The severe financial experience of the member firm community in the last half of 1972 and the first seven months of 1973 indicated that, without some form of rate increase, the ability of the industry to function would be impaired at the very time that it was expected to accomplish a transition to a competitive rate system (in a relatively short period of time), as well as the implementation of an extremely large number of other regulatory initiatives of a significant nature."

Id. The Commission further stated that while it would not necessarily require the Exchange, as a condition to continuing the rate increase after April 1, 1974, to adopt a rule allowing customers a 10% discount from the fixed rate for reduced services from their broker 72/ it adhered to the objective reflected in its September 11, 1973 conclusions "that the Exchanges take steps to effect a meaningful experimental period prior

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72/ See note, 71, supra.

to the introduction of completely unfixed rates. . . ." (Doc. App. 37) 73/ the Commission explained that with the "limited price competition [it hoped] . . . all exchanges will effect," a broader range

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73/ In response, the NYSE submitted to the Commission proposed amendments to the exchange's constitution and rules to allow for competitively-determined commission rates on public orders of $2,000 or less commencing on April 1, 1974. (Doc. App. 40 .) The NYSE's rule changes did not provide, however, that intra-members rates on portions of orders of $2,000 or less be competitively determined. The Commission decided not to raise any objection to these rule changes but conditioned its non-objection on the expectation that the exchanges will "promptly . . . implement any necessary rule and constitution changes" if "the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intra-member rates."

(Doc. App. 41). In order to aid its study of the matter, the Commission, on April 23, 1974, announced the commencement of public investigatory hearings beginning on May 29, 1974

> "to gather comments, views and data concerning whether the initiation in the near future of a limited experiement in competitive intra-member rates of commission on orders not exceeding $2,000 would cause substantial and irreparable harm to floor borkers or to the market-making function of specialists, and whether it is necessary or appropriate in the public interest or for the protection of investors for exchanges to maintain any prescribed schedules of intra-member rates of commission " (Doc. App. p. 42).

of investors would "have the opportunity to react to" competitive rates than would result from simply lowering the competitive-rate breakpoint below $300,000. Accordingly, the Commission determined that it would not be necessary to lower the breakpoint in April of 1974.

The Commission's program since 1968 of modifying the exchange's fixed rate structure has been paralled by related Commission initiatives which affect the exchange's commission rate structure as it relates to the proposed central market system. One of these initiatives is a program to provide non-member broker-dealers with greater access to the exchange market.[74/] The October 22, 1970, letter in which the Commission first requested that the NYSE adopt competitively-established commissions above certain levels (see supra, p. 45) (277a), also requested that the NYSE submit, no later than June 30, 1971, a plan that would provide "for reasonable economic access to the New York Stock Exchange for non-member broker-dealers." Such a program would, of course, provide non-members with a means of participating in the exchange market at rates below the otherwise applicable minimum commission rates. Thus, the Commission's request for a plan of non-member access, like its decision to implement negotiated rates at certain levels, reflected its conclusion that the commission rate structure, as it had been applied,

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74/ The NYSE, until the implementation of the Commission's program in this area, prohibited by rule its members from splitting commissions for transactions executed on the NYSE. The AMEX had a similar prohibition. These rules, known as the anti-rebate rules, were intended to preserve the integrity of the exchanges' fixed minimum commission rate system. See Thill v. New York Stock Exchange, Inc., supra, 433 F. 2d at 267.

was no longer necessary or appropriate under the standards contained in Section 19(b). But just as the Commission had been concerned that a precipitous leap to fully negotiated rates might have a calamitous impact upon the securities markets, it took steps to assure that changes in access for brokers would provide meaningful profits from stock exchange transactions executed for their customers, and that such changes would not occur at the expense of the health of the stock-exchange-member sector of the securities industry. Consequently, when the NYSE in mid-1971, submitted a proposal allowing non-members a discount of 30 percent from the public rate (Doc. App. 51), the Commission insisted that

> "the discount afforded non-member broker-dealers should not be less than 40% to allow for a minimum meaningful test of this proposal."

(Doc. App. 53). The initiation of non-member access was viewed by the Commission as an experiment and in later correspondence with the NYSE, the Commission emphasized that it was still conducting hearings on issues relating to the access question. It stressed that its "determination not to object to certain . . . [NYSE] proposals at [that] time should not be construed as a final disposition of the questions involved with the proposed rules or other rules adopted by the Exchange" (Doc. App. 55). A 40 percent discount for non-members went into effect in late March of 1972.

A second action taken by the Commission, which relates to the fixed minimum commission rate system, was the Commission's promulgation on January 16, 1973, of Rule 19b-2 under the Exchange Act, 17 CFR 240.19b-2.

The rule is intended to limit the use of exchange memberships for other than public purposes. Securities Exchange Act Release No. 9950 (January 16, 1973). In annoucing Rule 19b-2's adoption, the Commission noted that the rule satisfied several objectives, including

> "The need to structure a central market system, the need to eliminate unfair trading advantages, the need to restore and insure investor confidence in our trading markets, the need to foster meaningful competition in the securities industry, and the need to promote the orderly introduction of competitive commission rates on large-size securities transactions . . . ."

Id. at p. 188. Regulation of the use of exchange memberships was found to be necessary to implement the Commission's program of introduction of competitive rates because the use of exchange memberships by institutions for the purpose of recapturing brokerage commissions "would be tantamount to competitive rates (or no commissions at all) on all size orders for those institutions immediately" as a result of which "the Commission's phase-in-program would . . . become an academic exercise, at best." Id. at p. 107.

It can thus be seen that the Commission in conjunction with the exchanges has, since 1963, been engaged in a continuing regulatory program which has sought to examine fully the nature and effect of the national securities exchanges fixed rate system, and which has sought to structure the exchanges' operations not only with respect to the commission rates themselves but also with respect to a myriad of interrelated and interdependent matters. It is hard to conceive of a better example to demonstrate the

absolute necessity for entrusting exchange operations to an administrative agency with quasi-legislative authority, rather than to the ad hoc jurisdiction of antitrust courts.[75/]

75/ Not only does the record of Commission action with respect to commission rates illustrate the wisdom of Congress in delegating to the Commission quasi-legislative jurisdiction over the exchanges' rate structure, but this history of active exercise of Commission authority also requires that the exchanges' present rate structure be found immune from antitrust attack, even if this Court were to hold that the fact of jurisdiction by the Commission over the exchanges' fixed commission rate system alone does not afford such immunity.

The commission rate system existing at the time of the institution of this action, as well as the present system, is the product of the Commission's ongoing supervision. In the course of exercising this authority, the Commission determined that any precipitous move toward fully negotiated rates was not appropriate, but rather that the elimination of fixed rates at various levels should be the product of a deliberate, considered administrative program. It is just this type of action by a regulatory agency which the Supreme Cout has held to displace the antitrust laws. See Hughes Tool Co. v. Trans World Airlines, Inc., 409 U.S. 237 (1973). For to allow an antitrust attack in this case "would disrupt" the Commission's "delicate regulatory scheme, and would throw existing rate structures out of balance." United States v. R.C.A., 358 U.S. 334, 348 (1959). See also Georgia v. Pennsylvania R.R., 324 U.S. 499 (1945).

Furthermore, to the extent that the plaintiff is attacking in this lawsuit the graduated structure of the defendant exchanges' commission rate schedules on the grounds that those schedules discriminate against small investors it must be emphasized that that structure is the direct product of the Commission's regulatory program for introducing competitive rates in the industry. The Commission's regulatory authority over exchange commission rates necessarily entails authority "to alter or abolish a minimum rate schedule" (Independent Broker-Dealers' Trade Association v. Securities and Exchange Commission, 442

(footnote continued)

C. An Antitrust Action Is Not Required to Provide Review of Exchange Practices Relating to the Fixed Minimum Commission Rate Structure

Both plaintiff and the Antitrust Division argue (G. Br. 8-11; Div. Br. 19-22) that if an antitrust action were unavailable to attack exchange self-regulatory conduct subject to the Commission's jurisdiction review of anti-competitve exchange practices would be foreclosed. In this regard, it is claimed (Div. Br. 19-20) that because the Commission exercises its supervisory authority over exchange conduct in a "highly informal" manner, "there is substantial doubt that any judicial review is available to an aggrieved party." On the basis

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(footnote continued)

F. 2d 132, 143 (C.A.D.C.), certiorari denied, 404 U.S. 828 (1971); see also Stark v. New York Stock Exchange, Inc., supra, 346 F. Supp. 217) and thus entails discretion to determine what procedure should be followed in eliminating fixed minimum commission rates, and whether fixed minimum commission rates on various sized orders, or portions of orders below a certain breakpoint, should be retained. The defendants' present graduated commission rate structures, which are the product of the Commission's exercise of this regulatory authority granted to it by the Exchange Act are exactly the kinds of restraints "upon trade or monopolization" resulting from "valid governmental action" that the Supreme Court has repeatedly recognized to displace the Sherman Act. Eastern R.R. Pres Conf. v. Noerr Motors, 365 U.S. 127, 136 (1961); see also, United States v. Rock Royal Co-op, 307 U.S. 533, 560 (1939); Parker v. Brown, 317 U.S. 341 (1943); California Transport v. Trucking Unlimited, 404 U.S. 508, 516 n. 3 (1972) (Stewart, J. concurring).

of this assertion, the Antitrust Division thus contends (Div. Br. 21) that "[t]he exchanges would be free to adopt virtually any anticompetitive rule under the guise of 'self-regulation,' subject only to whatever review that the SEC in its own discretion thought appropriate, with no independent judicial" evaluation.

This argument is wholly without merit. At the outset, it is important to re-emphasize that the Supreme Court in Silver, supra, 373 U.S. 358-361, found that an antitrust action was the appropriate vehicle to review exchange self-regulatory conduct, where the challenged anticompetitive action by the exchange was not subject to the Commission's jurisdiction. It was in this absence of availability of review by the Commission, that the Court determined that reconciliation of the aims of the antitrust laws and the effective operation of the self-regulatory scheme of the Exchange Act had to be performed by an antitrust court to provide a check upon unfettered exchange discretion to pursue anticompetitive conduct. As the Court noted (Id. at 367), application of the antitrust laws to the self-regulatory conduct in Silver was designed "not [as] a brake upon the private partner executing the public policy of self-regulation but [as] a balance wheel."

But there is no need to resort to an antitrust action for the "balance wheel," where, as here, Commission jurisdiction exists

over the exchange self-regulatory practices. For as we have seen the Commission, in exercising its Section 19(b) authority to determine whether exchange activity with respect to "any important matter" is "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded upon such exchange or to insure fair administration of such exchange . . .," is required to and does accord consideration to anticompetitive factors.

In addition, it is clear that judicial review is available under the Administrative Procedure Act ("APA") for Commission action relating to exchange self-regulatory conduct that is subject to the Commission's jurisdiction, including the practices challenged here. Under Section 4(d) of the APA, 5 U.S.C. 553, any interested person may petition an administrative agency for the issuance, amendment or repeal of any rule of that agency. Thus, if an individual believes that any exchange rules subject to the Commission's quasi-legislative authority are improper, he may petition the Commission, inter alia, to promulgate a rule pursuant to Section 19(b) of the Exchange "to alter or supplement the rules of such exchange . . . ." And, if the Commission fails to act when required to do so, review may be sought in a federal district court to "compel agency action unlawfully withheld or unreasonably delayed." Section 10(d) of the APA, 5 U.S.C. 706.

Moreover, Section 10(a) of the APA, 5 U.S.C. 702, generally affords judicial review to persons "adversely affected or aggrieved by agency action within the meaning of a relevant statute . . . ," as well as to any "person suffering legal wrong because of agency action." In connection with this provision, the Court of Appeals for the District of Columbia Circuit has expressly held that a Commission "statement of policy that was intended to result in and does result in action on the part of companies that are regulated or subject to regulation, and [which] terminates or modifies outstanding business relationships," constitutes "agency action" subject to review in a district court to determine whether, in formulating the policy, the Commission acted ultra vires .[76/] Independent Broker-Dealers' Trade Association v. Securities and Exchange Commission, 442 F. 2d 132, 141-143, certiorari denied, 404 U.S. 828 (1971). Cf., PBW Stock Exchange, Inc. v. Securities and Exchange Commission, 485 F. 2d 718, 726, 733 (C.A. 3, 1973), certiorari denied, __ U.S. __ (1974).

76/ The propriety of the Commission's action would be measured by the standards of the Exchange Act, which, of course, requires consideration of competitive factors (see p. 29, supra).

Accordingly, district court review would be available, for example, where the Commission requests that an exchange change its rules and the exchange complies, or where, after investigatory hearings during which interested persons expressed their views on exchange rules, the Commission concludes not to object to a proposal by an exchange to amend its rules, and the amendments are then adopted by the exchange. 77/

77/ Neither Independent Investor Protective League v. Securities and Exchange Commission, No. 1984-71 (D.D.C., dismissed without opinion, June 19, 1972) nor Independent Investor Protective League v. Securities and Exchange Commission, No. 71-1924 (C.A. 2, dismissed without opinion, Nov. 15, 1971), respectively cited by plaintiff and the Antitrust Division, support their view that judicial review is unavailable through other than an antitrust action. As the defendants correctly point out in their brief at pages 32-35, since the Commission asserted numerous grounds in support of its motions to dismiss those cases, and since those cases were dismissed without opionion, it is impossible to conclude the bases for the dismissals. Moreover, in Independent Investor Protective League v. Securities and Exchange Commission, No. 73-2354 (C.A. 2, dismissed without opinion, December 11, 1973), the Commission--in asserting, as its sole ground for dismissal of the petition for review, that its September 11, 1973 conclusions with respect to the NYSE's rate structure (see pp. 47-48 supra) did not constitute an "order of the Commission reviewable in a court of appeals under the judicial review provisions of Section 25(a) of the Exchange Act, 15 U.S.C. 78y(a) --specifically noted that such Commission action might very well be subject to judicial review in a district court. See Memorandum in Support of the Securities and Exchange Commission's Motion to Dismiss in C.A. 2, No. 73-2354 at pp. 22-25.

The availability of adequate review of anticompetitive exchange rules also illustrates a basic fault in the two recent congressional securities industry studies which the Antitrust Division relies upon to support its argument that exchange rules under the Commission's jurisdiction are subject to the antitrust laws unless they are shown to be necessary to make the Exchange Act work. (See Div. Br. at 15-17, citing H.R. Rep. No. 92-1519, 92d Cong., 2d Sess. at 160-161 (1972) [H. Rep. 92-1519], and Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, Securities Industry Study 221 - 240, 93rd Cong. 1st Sess. (1973) [Securities Industry Study]. For both of those studies premised their conclusion as to the applicability of the antitrust laws to exchange rules, on the incorrect observation that there is no viable procedure for reviewing anticompetitive exchange rules except through an antitrust action. See H.R. Rep. 92-1519, at 163, 166-167; Securities Industry Study at 209-211, 219.

For these reasons, neither the plaintiff nor the Antitrust Division should be permitted to bootstrap themselves into the jurisdiction of an antitrust court based on an argument--a wholly unsupportable argument--that they have no other remedy.

CONCLUSION

For the foregoing reasons, the order of the district court should be affirmed.

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Dated: May 24, 1974

DOCUMENTARY APPENDIX

73D CONGRESS
2D SESSION

S. 2693

* * * *

REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under terms and conditions hereafter provided by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents here below set forth:

(1) An undertaking to comply with, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon with any provision of this Act and any amendment thereto and any rule or regulation made or to be made by the Commission thereunder.

(2) Such data as to its organization, rules of procedure and membership, and other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange."

(4) An undertaking to furnish to the Commission copies of any amendments to the documents or instruments mentioned in clause (3) of this subsection forthwith upon their adoption.

(b) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations made by the Commission thereunder and that the rules of the exchange are just and adequate to ensure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(c) The Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national

securities exchange within thirty days after the filing of the application, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of its filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(d) No registration shall be granted unless the rules of the exchange provide for the expulsion and suspension of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the violation of any provisions of this Act or any rule or regulation made by the Commission thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(e) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations of the Commission made thereunder and the applicable laws of the State in which it is located.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission and upon such terms as the Commission may fix, withdraw its registration.

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. . .

(c) The authority above given the Commission shall include, among other things, authority to prescribe such rules and regulations for national securities exchanges, their members and persons transacting a business in securities through such members, in addition to those specifically provided in this Act, as it may deem necessary or appropriate in the public interest or for the protection of investors, and may by its rules and regulations more specifically define the form and procedure to be followed in carrying the provisions of this Act into effect. The Commission, among other things, may prescribe the time and method of making settlements, payments, and deliveries, the time and method of calculating margin requirements, and the time and method of closing out under-margined accounts. The Commission, among other things, may by rules and regulations prescribe rules for the conduct of business on exchanges, for the classification of members, for the election of officers and committees to ensure a fair representation of the membership, for the suspension, expulsion, or disciplining of members, for the listing or striking from listing of any security with right of appeal by the issuer to the Commission, for the reporting of transactions on the exchanges and upon tickers maintained by or with the consent of any exchange, including the method of reporting short sales, sales of securities in default in bankruptcy or receivership, and

sales involving other special circumstances. The Commission may fix or prescribe the method of fixing uniform rates of commission, interests and other charges, may prescribe minimum units of trading, rules limiting the manner, method, and place of soliciting business, rules for odd-lot purchases and sales, rules regarding minimum deposits on marginal accounts, and rules limiting or prohibiting the registration or trading in any security within a specified period after the issuance or primary distribution thereof, prescribe rules governing the carrying of accounts and to prohibit fictitious or numbered accounts and require the disclosure of the real and beneficial owners thereof. The Commission shall have power to fix the hours of trading, and, if the public interest in its opinion so requires, summarily to suspend trading in any registered security or upon any registered exchange for a period not exceeding ninety days.

H. R. 7852

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SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under terms and conditions hereafter provided by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents here below set forth:

(1) An undertaking to comply with, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon with any provision of this Act and any amendment thereto and any rule or regulation made or to be made by the Commission thereunder.

(2) Such data as to its organization, rules of procedure and membership, and other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange."

(4) An undertaking to furnish to the Commission copies of any amendments to the documents or instruments mentioned in clause (3) of this subsection forthwith upon their adoption.

(b) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations made by the Commission thereunder and that the rules of the exchange are just and adequate to ensure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(c) The Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national

securities exchange within thirty days after the filing of the application, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of its filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(d) No registration shall be granted unless the rules of the exchange provide for the expulsion and suspension of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the violation of any provisions of this Act or any rule or regulation made by the Commission thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(e) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations of the Commission made thereunder and the applicable laws of the State in which it is located.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission and upon such terms as the Commission may fix, withdraw its registration.

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(c) The authority above given the Commission shall include, among other things, authority to prescribe such rules and regulations for national securities exchanges, their members and persons transacting a business in securities through such members, in addition to those specifically provided in this Act, as it may deem necessary or appropriate in the public interest or for the protection of investors, and may by its rules and regulations more specifically define the form and procedure to be followed in carrying the provisions of this Act into effect. The Commission, among other things, may prescribe the time and method of making settlements, payments, and deliveries, the time and method of calculating margin requirements, and the time and method of closing out under-margined accounts. The Commission, among other things, may by rules and regulations prescribe rules for the conduct of business on exchanges, for the classification of members, for the election of officers and committees to ensure a fair representation of the membership, for the suspension, expulsion, or disciplining of members, for the listing or striking from listing of any security with right of appeal by the issuer to the Commission, for the reporting of transactions on the exchanges and upon tickers maintained by or with the consent of any exchange, including the method of reporting short sales, sales of securities in default in bankruptcy or receivership, and

sales involving other special circumstances. The Commission may fix or prescribe the method of fixing uniform rates of commission, interests and other charges, may prescribe minimum units of trading, rules limiting the manner, method, and place of soliciting business, rules for odd-lot purchases and sales, rules regarding minimum deposits on marginal accounts, and rules limiting or prohibiting the registration or trading in any security within a specified period after the issuance or primary distribution thereof, prescribe rules governing the carrying of accounts and to prohibit fictitious or numbered accounts and require the disclosure of the real and beneficial owners thereof. The Commission shall have power to fix the hours of trading, and, if the public interest in its opinion so requires, summarily to suspend trading in any registered security or upon any registered exchange for a period not exceeding ninety days.

73D CONGRESS
2D SESSION

H. R. 8720

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents below specified:

(1) An undertaking to comply, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder.

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange".

(4) An undertaking to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations made thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

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DISCIPLINARY POWERS OVER EXCHANGES

SEC. 18. The Commission is authorized—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw altogether the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this Act or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or an issuer of a security registered thereon;

(2) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw altogether the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations made thereunder;

(3) After appropriate notice and opportunity for hearing by order to suspend for a period not exceeding twelve months or to expel altogether from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder or has effected any transaction for any other person who as he has reason to believe is violating in respect of such transaction any provision of this Act or the rules and regulations thereunder.

(4) If in its opinion the public interest so requires, summarily to suspend trading in any registered security for a period not exceeding ten days, and with the approval of the President, summarily to suspend trading upon any registered exchange for a period not exceeding ninety days.

(5) If after appropriate request in writing to a national securities exchange that such exchange should effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested and that such changes are necessary for the protection of investors or for the insuring of fair dealing in securities traded in upon such exchange or for the insuring of fair administration of such exchange, to alter or add to the rules, regulations, and practices of such exchange in respect of such matters as the classification of members and the methods of election of officers and committees to insure a fair representation of the membership; the suspension, expulsion, or disciplining of members; safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; the listing or striking from listing of any security; hours of trading; the

manner, method, and place of soliciting business; fictitious or numbered accounts; the time and method of making settlements, payments, and deliveries by members and customers; the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, in bankruptcy or receivership, and sales involving other special circumstances, the fixing of uniform rates of commission, interest and other charges; minimum units of trading; odd-lot purchases and sales, minimum deposits on margin accounts.

73D CONGRESS
2D SESSION

S. 3420

[Report No. 792]

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

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DISCIPLINARY POWERS OVER EXCHANGES

SEC. 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this Act or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon.

(2) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such transaction any provision of this Act or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of

such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, and other

charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

(c) The Commission is authorized and directed to make a study and investigation of the rules of national securities exchanges with respect to the classification of members, the methods of election of officers and committees to insure a fair representation of the membership, and the suspension, expulsion, and disciplining of members of such exchanges. The Commission shall report to the Congress on or before January 3, 1935, the results of its investigation, together with its recommendations.

73D CONGRESS
2D SESSION

H. R. 9323

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing agreements, setting forth information, and accompanied by documents, as follows:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

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POWERS WITH RESPECT TO EXCHANGES AND SECURITIES

SEC. 18. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission shall find that such exchange shall have violated any provision of this Act or of the rules and regulations thereunder or shall have failed to enforce, so far as is within its power, compliance therewith by a member.

(2) After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to withdraw, the registration of a security if the Commission shall find that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and

regulations thereunder, or has effected any transaction for any other person whom he has reason to believe is violating in respect of such transaction any provision of this Act or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or, with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) with respect to such matters as the classification of members and the methods of election of officers and committees to insure a fair representation of the membership; the suspension, expulsion, or disciplining of members; safe-

guards with respect to the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; the listing or striking from listing of any security; the making available, at appropriate times and upon reasonable terms and conditions, of the names and addresses of holders of listed securities; the manner, method, and place of soliciting business; fictitious or numbered accounts; the time and method of making settlements, payments, and deliveries, and of closing accounts; the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; the fixing of rates of commission, interest, listing, and other charges; minimum units of trading; odd-lot purchases and sales; minimum deposits on margin accounts; and similar matters.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SECURITIES EXCHANGE ACT OF 1934
Release No. 10206/June 6, 1973

The Securities and Exchange Commission announced that it has issued an order for the institution of an investigation and public investigatory hearing, pursuant to Section 21(a) of the Securities Exchange Act of 1934, to consider whether any changes should be made in the rules, policies, practices and procedures of one or more registered national securities exchanges respecting commission rate schedules.

The Commission announced that it had received on May 31, 1973 from the New York Stock Exchange, Inc. proposed revisions of that exchange's present commission rate schedule as contained in Article XV, Section 2 of its constitution and of its Rule 383 regarding service to small investors. The May 31 submission from that exchange and the Commission's order are attached hereto.

The Exchange informed the Commission that it expects to submit a documented economic report in support of the proposed revisions within a week. That report will be available to all interested persons in the Public Reference Section, Room 100 at the Commission's Headquarters Office, 500 North Capitol Street, N.W., Washington, D.C. 20459 and at each of the Commission's regional offices. Persons who wish to obtain a copy of that report may do so by writing to Dr. William C. Freund, Vice President and Chief Economist, New York Stock Exchange, Inc., Eleven Wall Street, New York, New York 10005.

It is the Commission's understanding that the NYSE's proposal to increase commission charges by 15% on orders from $5,000 up to $300,000 contemplates a 15% increase on the entirety of such orders rather than only on the portion of orders which exceeds $5,000. It is also the Commission's understanding that the proposed amendment to Rule 383 would enable member firms to charge small investors commissions in excess of the proposed 10% increase on orders involving from $100 to $5,000 or the proposed 15% increase on orders involving more than $5,000, i.e., the existing fixed commission on small investors' orders would become, as in the case of larger investors' orders, a minimum commission. Further, it would permit member firms to negotiate separate charges for other services rendered, such as custodial fees.

The Commission will also consider such other rule proposals as may be received from exchanges and, where appropriate, will issue a supplemental release describing them.

The Commission also announced that a public investigatory hearing on stock exchange commission rate proposals will convene at 10 a.m. Monday, July 9, 1973 at the Commission's headquarters, 500 North Capitol Street, N.W., Washington, D.C., to receive testimony and other relevant data on the foregoing NYSE commission rate proposals. The Commission has requested representatives of the NYSE to appear at that time to present testimony and relevant data and invites all other interested persons to submit their views. Persons who wish to appear and present factual material at the hearing are invited to notify the hearing officer (William E. Toomey, Room 632, Securities and Exchange Commission, 500 North Capitol Street, N.W., Washington, D.C., 20549, (202) 755-1240) of that desire as soon as possible and not later than July 9, 1973.

Witnesses will be expected to file with the hearing officer 25 copies of their prepared statements 48 hours prior to their appearance and are invited to make available additional copies at the time of their appearance for the benefit of the press and other interested persons. Other interested persons may wish to transmit written submissions for inclusion in the record in lieu of personally appearing. They should file 25 copies thereof to facilitate examination of the record by all interested persons. Such material should be submitted not later than July 23, 1973. All other communications should be filed in triplicate.

By the Commission.

Ronald F. Hunt
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES EXCHANGE ACT OF 1934
Release No. 10383/September 11, 1973

CONCLUSIONS OF THE SECURITIES AND EXCHANGE COMMISSION WITH RESPECT TO COMMISSION RATES

The Securities and Exchange Commission announced today its unanimous conclusions concerning the commission rate proposals of both the New York Stock Exchange, Inc. ("NYSE") and the PBW Stock Exchange, Inc. ("PBW"), which were the subject of a recent public investigatory hearing. 1/ Because of their importance to public investors, the national economy and the securities industry, the Commission has determined to announce its views immediately and publish shortly its letter to the exchanges embodying the reasons for its conclusions.

New York Stock Exchange Proposals

The NYSE has proposed to increase its fixed commission rates by 10 percent on orders ranging in size from $100 to $5,000, and by 15 percent on orders ranging in size from $5,001 to $300,000. The Commission today stated its conclusions that:

(1) It will not object if the NYSE immediately should adopt the proposed rate increase effective through March 31, 1974;

(2) It will not object to the continuation of such a rate increase from April 1, 1974, through April 30, 1975, if the NYSE should first adopt rules, effective by or before April 1, 1974, which (a) eliminate that portion of NYSE Rule 383 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedule, and (b) permit, but do not require, member firms to provide less than a full range of brokerage services presently furnished customers in return for discounts of up to 10 percent from the commission rate schedule referred to in subparagraph (1), above;

(3) It will act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the stock exchanges do not adopt rule changes achieving that result; and

(4) It will not initiate in April, 1974, a breakpoint reduction below $300,000 respecting the portion of orders above which rates may be competitively determined.

PBW Stock Exchange Proposal

The PBW has proposed rule changes which would permit its members to offer investors a 14-day round-trip commission rate--that is, the grant of a 50 percent reduction in the commissions charged on the second transaction (either an offsetting sale or purchase) executed within 14 days of a purchase or a sale of the same security. 2/ The Commission has concluded that it will object to the implementation of this round-trip commission rate proposal.

By the Commission.

George A. Fitzsimmons
Secretary

1/ See Securities Exchange Act Release No. 10206 (June 6, 1973); Securities Exchange Act Release Nos. 10245 (June 28, 1973) and 10337 (Aug. 10, 1973).

2/ See Securities Exchange Act Release No. 10245 (June 28, 1973).

December 14, 1973

Mr. James J. Needham
Chairman
New York Stock Exchange, Inc.
Eleven Wall Street
New York, N. Y. 10005

Dear Mr. Needham:

On September 11, 1973, the Commission announced its views concerning the commission rate proposals of both the New York Stock Exchange, Inc. ("NYSE") and the PBW Stock Exchange, Inc. ("PBW"). 1/ At that time, the Commission stated that, because of the importance of its views to public investors, the national economy and the securities industry, the Commission had determined to announce its views immediately and subsequently to indicate the bases for them. This letter sets forth the reasons for the Commission's conclusions with respect to your exchange's proposal to increase commission rates and with respect to the more fundamental issue of the manner in which the commission rates charged by members of all national securities exchanges should be determined in the future. 2/

The Conclusions Expressed by the Commission

The Commission, as you know, expressed five basic conclusions with respect to commission rates on September 11th:

(1) The Commission would not object if any national securities exchange should amend its rules immediately to increase its schedule of fixed commission rates member firms are required to charge their customers by 10 percent on orders up to $5,000 and by 15 percent on orders of more than $5,000, as had been proposed by the NYSE, nor to the continuation of those rates through March 31, 1974;

(2) The Commission will not object to the further continuation of those increased rates during the period from April 1, 1974, through April 30, 1975, by any stock exchange that adopts rules, effective on or before April 1, 1974, which

(a) eliminate that portion of NYSE Rule 383, or any comparable rule of another exchange, prohibiting member firms from charging their customers commission rates exceeding the exchange's commission rate schedule, and

(b) permit, but do not require, member firms to provide less than a full range of brokerage services furnished customers in return for discounts of up to 10 percent from the then effective commission rate schedule;

(3) The Commission will act promptly to terminate the fixing of commission rates by national stock exchanges after April 30, 1975, if the stock exchanges do not, on their own initiative, adopt rule changes achieving that result in advance of that date;

(4) The Commission will not, in April, 1974, initiate a breakpoint reduction below $300,000 respecting the portion of orders above which the commission rates charged by their members may be competitively determined; and

SECURITIES EXCHANGE ACT OF 1934
Release No. 10560/December 14, 1973

The Securities and Exchange Commission today announced that it had sent the following letter to James J. Needham, Chairman of the Board of Directors of the New York Stock Exchange, Inc., setting forth the reasons for the conclusions articulated by the Commission on September 11th with respect to, among other things, the New York Stock Exchange's proposal to increase their schedule of commission rates.

The text of the letter was as follows:

(5) The Commission expressed its disagreement with the PBW's proposal to permit its members to reduce commission rates by 50 percent on the second transaction (either an offsetting sale or purchase) executed within 14 days of a prior purchase or sale of the same security by the same person.

As noted above, 3/ this letter sets forth some of the policies considered and formulated by the Commission with respect to the first four of the foregoing five conclusions articulated by the Commission on September 11, 1973, concerning commission rate schedules of national securities exchanges.

The NYSE's Proposal to Raise Its Schedule of Member Commission Rate Charges

In order to place the conclusions articulated by the Commission on September 11th in proper perspective, it is important to recognize the nature and regulatory context of the action the NYSE proposed to take.

The NYSE submitted to the Commission a proposed amendment to its rules designed to effect an increase in the commissions it members are required to charge their customers for the portion of those transactions effected on the exchange that do not exceed $300,000. This proposal had, as you are aware, been preceded by earlier NYSE proposals also designed to modify, in some manner, its rules fixing the level and rate of commissions charged by its members.

While Congress, in enacting the Securities Exchange Act in 1934, did not explicitly authorize exchanges to fix the rates of commissions their members could charge, it did implicitly recognize that national securities exchanges might fix the commissions their members are required to charge if this practice did not meet with Commission disapproval. 4/ As is also true of other powers which may reside with the exchanges by virtue of the Securities Exchange Act, any power to adopt rules fixing commission rate charges is not an unfettered authority. First, the exchanges were not authorized to fix commission charges which are unreasonable. And second, Section 19(b) (9) of the Securities Exchange Act vests pervasive residual authority in the Securities and Exchange Commission to alter, modify or amend any rules or practices of exchanges fixing rates of commission and other charges, including their elimination, notwithstanding the apparent concern of some members of Congress in 1934 that the Commission might abuse its authority over exchange rules fixing commission rates by causing those rates to be set too low. 5/

But, to the extent any such rules are appropriate, the promulgation of rules concerning exchange-required fixed commission rates is a matter that Congress entrusted to the exchanges in the first instance, at least as long as the fixing of commission rates should be permitted. 6/ The NYSE's rate proposal was submitted to us pursuant to Securities Exchange Act Rule 17a-[illegible] CFR 240.17a-8, generally requiring that advance notice be given to the Commission by any exchange proposing to amend its rules or practices. Our consideration of the NYSE's proposal was in the context of a determination whether the Commission should take any steps preliminary to the exercise of its authority concerning the effectiveness of the NYSE's proposed action.

We have considered the reasons why the NYSE proposed to increase the level of commission rates its members must charge, as well as the authority accorded to the exchanges by the Congress in 1934, and for the reasons enumerated below, we could not conclude that the NYSE's rate proposal was unreasonable.

In support of its proposal to raise commission rates, the NYSE provided the Commission with a substantial amount of information in support of the Exchange's position that member firms 7/ have in the last 18 months experienced increases in the prices paid for goods and services.

The Exchange attempted to measure the effect of general inflationary forces and suggested specifically that substantial increases in the cost per transaction resulting from inflationary factors alone warranted a commission rate increase in the amount the Exchange had requested. 8/

The Commission recognizes that there has been some inflation in costs since the last increase effected by the Exchange in its schedule of commission rates and that Exchange members were not in a position to pass these increased costs on to their customers, largely because of the existing fixed rate schedule applicable to the vast bulk of orders executed on national securities exchanges. The Commission is also aware that, for a protracted period, there had been a substantial decline in the volume of transactions on exchanges, which aggravated the effects of the cost increases that, in fact, had occurred. 9/

The Commission finds more significant, however, the Exchange's submission of information which clearly showed that its member firm community had been experiencing severe financial losses for a substantial period preceding the rate request.

Although the profitability of NYSE member firms carrying public customer accounts, in terms of pre-tax rate of return on capital and in terms of profit margin (pre-tax return as a percentage of gross revenue) were 18.9 percent and 12.8 percent, respectively, for the full year of 1972, rates of return in the last half of 1972 had declined below their historical average levels. 10/ For the first seven months of 1973, NYSE member firms doing a public business 11/ as a group, suffered pre-tax losses of $195 million on total securities activity.

This decline in profitability in the last half of 1972 and loss condition in the first seven months of 1973 was apparently experienced by firms of all types, whether regional or national, and whether serving primarily large investors or primarily small investors. Not only was there an indication that roughly one-half of the NYSE firms which carried public customer accounts were suffering such severe losses, it was also clear that, if the same level of losses that had occurred in early 1973 continued, in less than twelve months seventy-six of these firms would be unable to meet the requisite net capital requirements for doing business.

Thus, on the basis of the financial experience of the industry in late 1972, and the first seven months of 1973, it did not appear that unreasonable rates of return were likely to result if the proposed rate increase were effected by the

NYSE. On the other hand, without the rate increase, the continued deterioration in the capital positions of many member firms was foreseeable, with significant capital impairment and indirect, but consequential, harm to investors the likely result.

These circumstances principally motivated the Commission to raise no objection to the NYSE's rate increase for the period ending March 31, 1974.

The Move to Unfixed Commission Rates

The Commission's conclusion that it would be appropriate to require exchanges to eliminate fixed commission rates effective by April 30, 1975, of course, also had some influence on its conclusion not to object to the specific rate increase proposed by the NYSE.

The Commission has consistently taken the position that the long history of fixed rates argues against a precipitous elimination of the fixed rate system. It is appropriate, for the protection of investors and in the public interest, that stock exchange firms be given an opportunity to develop business strategies and adjust their operations to a competitive-rate environment. It is not appropriate to risk the possibility that undue haste might threaten the ability of the industry to fulfill its essential function of serving the needs of investors and corporations seeking capital from the public. The severe financial experience of the member firm community in the last half of 1972 and the first seven months of 1973 indicated that, without some form of rate increase, the ability of the industry to function would be impaired at the very time that it was expected to accomplish a transition to a competitive rate system (in a relatively short period of time), as well as the implementation of an extremely large number of other regulatory initiatives of a significant nature. 12/

The Commission does not, however, view this letter as the appropriate place to articulate definitively the reasons for its conclusion that the fixing of commission rates on securities transactions should be terminated by April 30, 1975. Should it become necessary for the Commission to request Exchange action in the manner prescribed by Section 19(b) of the Securities Exchange Act, however, the Commission will set forth the basis upon which it is, at that time, requesting that specified action be taken. 13/

Predicates for the Extension of an Increase in Fixed Commission Rates from April, 1974 through April, 1975

In its release issued on September 11th, the Commission indicated its view that it would not object to the further continuation -- for the period from April 1, 1974, through April 30, 1975 -- of the increase in Commission rates proposed by the NYSE, if the NYSE should first effect changes in its rules designed to permit an interim period during which member firms could both (1) charge up to 10 percent less than the exchange-fixed minimum rate schedule if they should provide less than the full range of brokerage services generally being furnished at the present time, and (2) charge more than the exchange-fixed minimum rate schedule if they believe such increased charges are appropriate.

We understand through conversations with representatives of the exchanges and the member firm community that there is some question whether the foregoing proposal represents a workable opportunity for experimentation with limited price competition. We adhere, however, to our objective that the exchanges take steps to effect a meaningful experimental period prior to the introduction of a system of completely unfixed commission rates, even if it should take the form of a modification of our proposal or some other realistic alternative to it. We believe the exchanges and the member firm community should assume the initiative for developing a program fostering limited price competition during this period prior to the introduction of unfixed rates if there is a desire to retain the commission rate increase that was the subject of our September 11th release beyond April 1, 1974, and we request timely initiatives by the exchanges and other interested persons to effect this aspect of the Commission's September 11th conclusions.

Lack of any Need for Further Reductions in the Breakpoint at which Member Firms May Negotiate Commission Charges

The Commission heretofore has encouraged a program of phased reductions of the breakpoint above which member firms may competitively determine commission rate charges. The volume discounts effected by the several exchanges since 1968 at the Commission's suggestion, as well as the phased introduction of competitively-determined rates on the portion of all stock exchange orders exceeding $300,000, certainly have effected necessary changes in the exchange-fixed commission rate structure which had created certain distortions in trading activities. These changes, however, were dispositive of a number of problems raised by larger firms or institutional investors. With the experiment in limited price competition that we hope all exchanges will effect, other investors, not merely those with large orders, will have the opportunity to react to the limited range of competitive rates this next step can provide. Accordingly, the Commission has concluded that it is not necessary to initiate an April, 1974, competitive rate breakpoint reduction to a point below $300,000.

For the reasons discussed above, the Commission believes that the rate increase of limited duration, and the phasing-in of competitively determined rates during the transitional period beginning by April 1, 1974, we envision, will assist in achieving a market structure and commission rates that will better serve the interests of investors, the broker-dealer community, stock exchanges and the issuers whose securities are traded thereon. We expect, in the spirit of cooperation that is vital to the viability of any regulatory program, that your exchange, as well as the other national securities exchanges, will timely initiate rule changes consistent with the views expressed in this letter and in our release of September 11th, 1973. We look forward to working with the NYSE and all other interested persons to achieve these ends.

For the Commission,

Ray Garrett, Jr.
Chairman

1/ Securities Exchange Act Release No. 10383 (Sept. 11, 1973).

2/ Although the NYSE was the only national securities exchange which formally proposed amendments to its rules designed to effect increases in its schedule of commission rate charges on the portion of all securities orders handled by exchange members not exceeding $300,000, others of the registered securities exchanges had advised us of their intention to effect increases in their commission rate schedules comparable to those proposed by the NYSE.

3/ *See* p. 1, *supra.*

4/ Section 6(c) of the Securities Exchange Act, 15 U.S.C. 78f(c), authorizes an exchange to adopt "any rule not inconsistent with . . ." the Act or applicable state law. And Section 19(b) (9) of the Act, 15 U.S.C. 78s (b) (9), authorizes the Commission to alter, modify or amend any existing exchange rules fixing commission rates.

5/ *See, e.g.,* the remarks of Congressman Pettengill during the House floor debates on the Securities Exchange Act:

> "the Commission could fix rates of commission . . . so low that no broker could stay in business and thus [the Commission could] destroy his business . . ."

78 Cong. Rec. 8091 (1934).

6/ *See* pp. 8 - 10, *infra.*

7/ Reference to the NYSE member firm community is not intended to indicate any failure to consider the circumstances of the members of other registered national securities exchanges. Indeed, the Commission has considered the fact that about 30 percent of all regional stock exchange member firms and over 80 percent of American Stock Exchange member firms also are NYSE member firms and believes that financial data concerning the NYSE firms for present purposes reasonably represents the financial experience of exchange members generally. And see note 2, *supra.*

8/ The Exchange submission included an attempt to measure the degree to which inflationary forces had increased the cost of brokerage firm payrolls and other goods and services purchased by member firms, proposing that the inflationary increase in costs experienced by member firms exceeded 17 percent between April, 1970, and April, 1973.

For example, exchange estimates of increases in the cost of specific items included a 19.1 percent increase in wages and salaries, a 55.9 percent increase in other employee benefits, a 15.2 percent increase in telephone and telegraph costs and an 8.7 percent increase in rental expenses.

The Commission is persuaded that significant cost increases have in fact occurred, whether or not the effect of such increases can be demonstrated to be in the precise degree suggested by the NYSE. Such increases, of course, must be, and in fact have been, considered along with other factors in determining whether or not the anticipated results of the proposed rate increase would be unreasonable.

9/ In the second quarter of 1973, the value of trading on the NYSE had declined to a level 18 percent below the level of the same period in 1972. On the AMEX, the value of trading had declined 62 percent over the same period. In the first eight months of 1973, the value of trading was down 13.2 percent on the NYSE and 55.9 percent on the AMEX from the comparable period in 1972.

10/ These data are based upon the unconsolidated pre-tax profit figures reported by such firms on their Joint Regulatory Report, a monthly report the NYSE requires its members to file with it. Data are available on a consolidated basis for the years 1965 through 1972 from the annual income and expense reports filed by NYSE member firms carrying public customer accounts.

11/ This includes both firms carrying public customer accounts and introducing firms.

12/ In this context, it should be noted that Senator Harrison A. Williams, Jr., Chairman of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, in his July 27, 1973, statement submitted to the Commission in its recent hearings on the NYSE's rate proposal, suggested:

> ". . . that the Commission use the present public proceeding to establish a blueprint for totally eliminating fixed brokerage rates. The Commission should announce a definite date for the end of price-fixing. The date should be sufficiently distant to allow the industry to adjust and plan adequately for a competitive environment, but it should be near enough to furnish the industry, the self-regulatory organizations and the Commission with the impetus to concentrate on and pursue measures which hold the promise of substantially reducing costs and improving the efficiency of broker-dealer operations. Suggestions for setting such a date 12 to 18 months hence, appear to me to be reasonable.
>
> "In the event the Commission adopts the approach I am recommending, I believe it would be entirely appropriate for it to consider increasing fixed rates during the interim period. In light of the apparently severe profit squeeze in the industry such a rate increase may well be appropriate in the public interest."

13/ The Commission is aware of the present significance to the exchanges and their member firms of its view that fixed rates be abolished. For this reason, and in order to aid the exchanges in the formulation of appropriate rules, the exchanges should be aware of the following factors which have influenced the Commission's conslusion:

(1) The Commission is concerned that the heterogeneous nature of the brokerage industry militates against applying one fixed commission rate schedule to all elements in the industry.

(2) The Commission believes that, even without fixed minimum commission rates, the advantages of best execution for customer orders and the convenience and benefits, both to brokers and customers, of clearance and other services will cause trades to be brought to the exchange mar-

ket. In any event, however, the Commission is satisfied that it has the authority necessary to assure that abandonment of exchange membership is not a means to evade the investor protection obligations incident to exchange membership.

(3) The Commission has substantial doubt whether, in fact, small investors' transactions are subsidized by fixed commission charges to institutional investors, to the extent this is suggested as a rationale for the maintenance of fixed rates.

(4) The Commission is not persuaded, as some members of the industry apparently are, that fully competitive rates would result in large firms forcing small firms out of business; small regionally-located firms have disagreed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 10670/March 7, 1974

ANNOUNCEMENT IN RESPONSE TO COMMISSION RATE PROPOSALS

The Commission announced today that it has responded to the New York Stock Exchange's proposals to initiate a program for limited price competition commencing April 1, 1974 on non-member orders involving up to $2,000 and to rescind existing prohibitions against charging, on orders involving more than $2,000, commissions in excess of the rates provided in stock exchange commission schedules. Further, the Commission responded to an NYSE request that minimum intra-member rates for floor brokerage and clearance functions be retained on orders not exceeding $2,000 and that a public investigation be made of the likely effects of introducing intra-member competitive rates for execution and clearance. The Commission stated that pending further study of, and solicitation of the public's views and comments on, whether current rules fixing intra-member rate charges prevent an adequate experiment with limited price competition, it would not object to implementation, by April 1, 1974, of the limited unfixing of non-member rates described above. The text of the Commission's letter follows:

March 6, 1974

Mr. James J. Needham, Chairman
New York Stock Exchange, Inc.
11 Wall Street
New York, N. Y. 10005

Dear Mr. Needham:

This is in response to the letters of the New York Stock Exchange ("NYSE"), dated February 7 and 21, 1974, which submitted to us, pursuant to Securities Exchange Act Rule 17a-8, 17 CFR 240.17a-8, proposed amendments to the NYSE's Constitution and Rules respecting commission rates. These letters responded to the statement in our letter of December 14, 1973, to the NYSE, that "the exchanges and the member firm community should assume the initiative for developing a program fostering limited price competition during" the period between April 1, 1974, and April 30, 1975. Accordingly, the NYSE's February 7th letter proposed amendments to Article XV of its Constitution, which would:

(1) provide for competitive nonmember and intramember commission rates on all orders not exceeding $2,000; (2) rescind the prohibition now set forth in NYSE Rule 383 against charging commissions exceeding the existing exchange schedule of minimum rates applicable to orders exceeding $2,000; and (3) otherwise rescind NYSE Rule 383.

In its letter of February 21, the NYSE modified its original suggestions for Constitutional and Rule changes by deleting its proposed amendments respecting intramember rates for floor brokerage and clearance functions on orders not exceeding $2,000 (Sections 2(b) and 2(c) of Article XV of the NYSE Constitution). In this regard, the NYSE stated that no study has been made of the likely effects of intramember competitive rates and requested the Commission to conduct an investigation of this matter.

Pending further study of, and solicitation of the public's views and comments on, the question whether the retention of your current rules fixing intramember rate charges for orders not exceeding $2,000 prevents the adequate experiment with limited price competition in which we previously indicated the exchanges should engage, we will not raise any objection if the NYSE should effect the rate proposals set forth in its letter of February 21. If the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intramember rates, we expect that you promptly will implement any necessary rule and constitutional changes.

The Commission appreciates the NYSE's timely efforts to begin a constructive experiment with limited price competition on April 1, 1974.

Sincerely,

Ray Garrett, Jr.
Chairman

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SECURITIES EXCHANGE ACT OF 1934
Release No. 10751/April 23, 1974

NOTICE OF PUBLIC HEARING ON INTRA-MEMBER COMMISSION RATE SCHEDULES OF REGISTERED NATIONAL SECURITIES EXCHANGES

The Securities and Exchange Commission today announced that a public investigatory hearing, ordered pursuant to the Commission's authority under the Securities Exchange Act of 1934 ("Exchange Act"), including, but not limited to, Exchange Act Section 21(a), 15 U.S.C. Section 78u(a), will be held beginning May 29, 1974 to receive oral and written comments, views and data concerning whether any changes should be made in the rules, policies, practices and procedures of registered national securities exchanges prescribing minimum rates of commission for business performed by one member for another ("intra-member rates"). The hearing will convene at 10 a.m., Wednesday, May 29, 1974, in Room 776 at the Commission's headquarters, 500 North Capitol Street, Washington, D.C. 20549.

In Exchange Act Release No. 10383 (September 11, 1973), the Commission announced its determination not to object to the proposal of the New York Stock Exchange, Inc. ("NYSE") to increase by 10 percent its fixed commission rates on non-member orders ranging in size from $100 to $5,000, and by 15 percent on non-member orders ranging in size from $5,001 to $300,000. The Commission also announced in that Release that it would initiate action to terminate the fixing of commission rates by securities exchanges after April 30, 1975 if the exchanges have not amended their rules to effect such termination by that date and that, in order for the rate increase to continue from April 1, 1974 through April 30, 1975, the NYSE should adopt a program of rule changes, effective on or before April 1, 1974, which (a) eliminate that portion of NYSE Rule 383 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedule and (b) permit members to engage in a limited but adequate experiment in competitive commission rates. These conclusions were applied also to every exchange which adopted, and desired to continue in effect, the 10 percent and 15 percent commission rate increases. In Exchange Act Release No. 10560 (December 14, 1973), the Commission requested the exchanges to initiate timely development of such a program of rule changes.

In a letter dated February 7, 1974, the NYSE submitted to the Commission proposed amendments to its constitution and rules to rescind Rule 383, to provide for competitive commissions on both member and non-member orders of $2,000 or less and to rescind the prohibition against charging commissions exceeding minimum rates. By letter dated February 21, 1974, the NYSE modified its proposal by withdrawing those of its proposed amendments which would have subjected intra-member commission rates to competition on orders of $2,000 or less.

In its letter, the NYSE also stated the following:

> The Exchange does not believe, however, that it is necessary to amend those provisions of the Constitution dealing with floor brokerage and clearance (Article XV, Sections 2(b) and 2(c)) in order to provide the experimentation sought by the Commission in its letter of December 14, 1973. No study has been made of the likely impact in the intra-member competitive rates, but quite clearly this impact might be unexpectedly severe on those members and member organizations which are largely dependent on these floor brokerage and clearance rates. A serious erosion in floor brokerage income could have a harmful impact on the essential market making function of specialists.
>
> The Board of Directors is not aware that there has been any meaningful accumulation of data on an industry wide basis as to the possible impact of negotiated intra-member rates. Because of the importance of this question with regard to the restructuring of the industry, the Board of Directors urges the Commission to conduct a public investigation of this matter pursuant to Section 21 of the Securities Exchange Act of 1934. This procedure would enable all interested parties to be heard and should provide the essential information needed to make an appropriate determination of this question. The Board urges that this procedure be initiated promptly so that it be completed well in advance of April 30, 1975.

In Securities Exchange Act Release No. 10670 (March 7, 1974), the Commission responded to the NYSE's modified proposals, stating:

> Pending further study of, and solicitation of the public's views and comments on, the question whether the retention of your current rules fixing intramember rate charges for orders not exceeding $2,000 prevents the adequate experiment with limited price competition in which we previously indicated the exchanges should engage, we will not raise any objection if the NYSE should effect the rate proposals set forth in its letter of February 21. If the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intramember rates, we expect that you promptly will implement any necessary rule and constitutional changes.

Somewhat similar statements respecting intra-member rates were received from, and corresponding replies were sent to, other stock exchanges in connection with their proposals to implement, by April 1, 1974, the same limited experiment in competitive commission rates.

Interested persons who desire to appear or to submit written comments, views or data in this matter may wish to review materials submitted in the investigatory hearings conducted by the Commission in 1970 and 1971 concerning the reasonableness

of, and the need for, minimum intra-member rates. These materials are contained in the following documents, which are available for inspection in the Commission's Public Reference Section, Room #6101, 1100 "L" Street, N.W., Washington, D.C. 20005 (copies of the hearing transcripts listed below may also be available in the Commission's regional offices):

Hearing Transcripts

In the matter of Commission Rate Schedules of Registered National Securities Exchanges.

File No. 4-144-1-17, July 20, 1970,
Pages 5996-6037

File No. 4-144-1-18, July 21, 1970,
Pages 6188-6199 and Pages 6205-6208

File No. 4-144-1-22, July 12, 1971,
Pages 7279-7295

File No. 4-144-1-22, July 13, 1971,
Pages 7551-7586 and Pages 7594-7597

File No. 4-144-1-22, July 14, 1971,
Pages 7599-7606 and Pages 7622-7625.

Exhibits

In the matter of Commission Rate Schedules of Registered National Securities Exchanges.

File No. 4-144-1-10 (NYSE)
Exhibit 29-A - "Report on New Commission Rate Schedule"
dated July 13, 1970, Pages 19-20

File No. 4-144-1-14 (NYSE)
Exhibit 71-1 - "Report on New Minimum Commission Rate Schedule"
dated July 12, 1971, Pages 21-26.

The purpose of the hearing is to gather comments, views and data concerning whether the initiation in the near future of a limited experiment in competitive intra-member rates of commission on orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists, and whether it is necessary or appropriate in the public interest or for the protection of investors for exchanges to maintain any prescribed schedules of intra-member rates of commission. It will be necessary, if such schedules of intra-member rates are to be retained, for the Commission to have a basis upon which to judge the reasonableness of such rates. The following questions are intended to elicit such information. Persons who wish to offer oral or written statements for the record of the hearing are invited to comment on the following questions and other matters related to intra-member rates.

(1) What reason is there to conclude that an experiment until April 30, 1975 in competitive intra-member rates for orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists? If members without their own floor brokers ("off-floor members") are competitively disadvantaged as against vertically-integrated members (i.e., members having their own floor brokers) by the present fixing of intra-member rates (see question (12)), will permitting fixed intra-member rates on orders not exceeding $2,000 during the period of experimentation with competitive non-member rates on such transactions, exacerbate the competitive disadvantage of off-floor members or, as between off-floor members and vertically-integrated members, cause statistically biased results respecting competitive non-member rates?

(2) Are intra-member rate schedules for (a) clearance services or (b) floor brokerage services necessary or appropriate for the protection of investors, or to insure fair dealing in securities traded upon an exchange, or to insure fair administration of an exchange?

(3) Assuming it is necessary or appropriate to have intra-member rate schedules for clearance functions, should such rates be higher than the clearing fees charged by a clearing corporation for direct mail clearance? Should they be different for orders effected for the member's own account than for orders effected by such member for other persons? (Compare Sections 2(b) and 4 of Art. XV of the NYSE Constitution.)

(4) Should intra-member rate schedules for execution be applicable to

(a) orders left with specialists (or, in the case of the Chicago Board Options Exchange, board brokers),

(b) services provided by a floor broker not acting as a specialist, or

(c) both?

(5) Should intra-member rate schedules for floor brokerage be different for different types of orders (e.g., market orders, limited price orders, percentage orders, not-held orders)?

(6) Should a member who provides execution and clearance services for other members and for non-member brokers be prohibited from lowering its prices if it believes such action is necessary to retain the business it receives from correspondents?

(7) Assuming it is necessary or appropriate for exchanges to retain intra-member rate schedules for floor brokerage, what standards should be used to determine their reasonableness? Please answer the following questions separately for (a) floor brokers not acting as specialists and (b) specialists, and explain whether your answers would differ depending on whether the intra-member rate schedules would provide for a minimum rate with no maximum, a fixed rate which is

both a minimum and a maximum, or a maximum rate with no minimum:

(i) What expenses should be allowable in determining floor brokerage rates?

(ii) Should rate of return on investment be the standard used to determine the reasonableness of levels of profitability? If so, what should be the base of the rate of return, i.e., equity capital or equity and debt capital?

(iii) What rate(s) of return should be allowed?

(iv) In order to provide excess floor brokerage capacity (if that is needed), must rates for floor brokerage be more than "economic cost-remunerative" (cover more than costs plus reasonable profit), or, absent such subsidy, would the number of available floor brokers increase quickly enough to accommodate sudden increases in demand? If excess capacity for floor brokerage services is needed, how much is needed and can it be supplied at lower cost by the automation of certain types of orders?

(v) Do intra-member rate schedules for floor brokerage which are more than economic cost-remunerative, or which compensate for maintaining excess capacity, unduly inhibit the automation of floor brokerage services?

(vi) Can costs and capital of non-specialist floor brokers be allocated among agency activities and their other activities? If so, how? If a member engages generally in the securities business in addition to providing floor brokerage services, should costs and capital be allocated between floor brokerage done for that member's own organization and that done for other member organizations?

(vii) Can costs and capital of specialists be allocated among specialists' broker functions, dealer functions and their other activities?

(viii) Should the standards for measuring the reasonableness of costs and rates of return differ in formulating intra-member rate schedules for specialists and for floor brokers?

(8) If exchanges are to retain schedules of intra-member rates of commission for specialists,

(a) should the specialist receive all or part of the intra-member rate for floor brokerage when he acts as broker with respect to an order left on his book? (Compare NYSE Constitution Art. XV, Section 2(c), which provides for payment of the full

intra-member floor brokerage rate on that exchange to the specialist when he acts as broker for an order left with him, and American Stock Exchange, Inc. ("Amex") Constitution Art. VI, Section 2(c), which provides under similar circumstances for payment of approximately 3/4 of the intra-member rate for floor brokerage to the specialist, leaving approximately 1/4 for retention by the floor broker.)

(b) should the answer to (a) differ if the specialist acts as dealer with respect to such an order? (Compare the above NYSE and Amex constitutional provisions with Midwest Stock Exchange Article XXVIII, Rule 22.)

(9) Should intra-member rates paid to specialists on orders left with them be more than economic cost-remunerative in order to subsidize the specialist's dealer obligation? If so, can the amount of subsidy be calculated (and periodically adjusted) to do no more than subsidize the dealer obligation to the extent such a subsidy is required?

(10) (a) Assuming that the quality of specialists' dealer performance <u>can</u> be objectively evaluated,

(i) should floor brokerage income from the execution of orders left with all specialists on an exchange be pooled and then allocated by the exchange to specialists on the basis of performance?

(ii) if there is no pooling of floor brokerage income, should an exchange structure its schedule of rates so that a high-rated specialist would receive a larger portion of the floor brokerage income from orders left with him than he would if he were low-rated?

(iii) if there is no pooling of floor brokerage income and no differentiation in the amounts paid to specialists on the basis of their ratings, should an exchange reallocate stocks among specialists from time to time to reinforce high standards of specialist performance?

(iv) to what extent, if any, should any allocation of pooled floor brokerage income, or differentiation in amounts paid to specialists on the basis of their ratings, or periodic reallocation of stocks, take into account a specialist's profitability, or lack thereof, in addition to his dealer performance rating?

(v) to what extent, if any, should any allocation of pooled floor brokerage income, or differentiation in amounts paid to specialists on the basis of their ratings, or periodic reallocation of stocks be designed to achieve a subsidy of specialists' dealer activity in less profitable stocks?

(b) Could a prescribed intra-member rate for specialists' floor brokerage services which included an amount intended to subsidize the specialists' dealer functions meet the test of reasonableness

if the quality of specialists' dealer performance cannot be objectively evaluated?

(11) (a) Does assignment by an exchange of the book to one specialist confer an undue competitive advantage upon him over other market makers on and off such exchange who would be willing to share the specialist's dealer obligations if they participated in his subsidy?

(b) If liquidity with depth is provided by competing market makers on or off an exchange (other than the exchange specialist) and the exchange retains intra-member rates for specialists which include a subsidy,

(i) should provision be made for such other market makers to receive a portion of the subsidy, and should the answer depend upon whether they supply such liquidity with depth for competitive reasons, or pursuant to their assumption of affirmative obligations; or

(ii) should each such market maker (including the specialist) have his own book and corresponding subsidy? If so, under what conditions?

(12) Do intra-member rates which are more than economic cost-remunerative place off-floor members at a competitive disadvantage as against vertically-integrated members? If intra-member rates on limit orders left with specialists are not to be merely economic cost-remunerative but, as a matter of policy, are to include a subsidy for the specialist's market-making function, can intra-member rates for floor brokerage be the same for floor brokers as for specialists without competitively disadvantaging off-floor members?

(13) Assuming that the specialist's dealer function should be subsidized through intra-member rates on orders left with specialists and that excess floor brokerage capacity should be subsidized through separate intra-member rates for floor brokerage, will each of these assumed needs result in identical intra-member rates for specialists' agency services and for floor brokers' services? If the two have different costs or capital requirements, should exchange-mandated intra-member rates for agency services nevertheless be the same? If the intra-member were to be different for agency services provided by specialists and floor brokers, or were to be prescribed in the case of one but not the other, would this produce results inconsistent with the protection of investors, fair dealing or fair administration of the exchange?

(14) Various securities exchanges impose charges and fees, payable by one member to another member, for services other than traditional floor brokerage and clearance. For example, when a market-maker member on the PBW Stock Exchange, Inc. effects a principal transaction in one of the stocks in which he is registered with that exchange as an alternate specialist, he must pay 1¢ per share to the regular

specialist in that stock (Rule 459). On the Midwest Stock Exchange, Incorporated a member (who is not a specialist) who deals as principal with another member is entitled to receive from that other member a fee equal to the rate of floor brokerage (Art. XXVIII, Rule 22). Are such required fees and charges necessary or appropriate? What standards should be used to determine the reasonableness of such fees and charges?

Persons who wish to appear at the hearing are requested to notify the hearing officer, William E. Toomey, Room 632, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, telephone number (202) 755-1240, as soon as possible.

Persons intending to appear should file 25 copies of the text of their prepared oral statements with the hearing officer 48 hours prior to their appearance and are invited to make additional copies of their statements available at the time of their appearance for the benefit of the press and all other interested persons.

Persons wishing to submit written statements for the Commission's consideration, in lieu of appearing personally, should file 25 copies thereof no later than June 14, 1974.

By the Commission.

George A. Fitzsimmons
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of INTRA-MEMBER COMMISSION RATE SCHEDULES OF REGISTERED NATIONAL SECURITIES EXCHANGES	ORDER DIRECTING PUBLIC INVESTIGATION AND DESIGNATING OFFICERS TO TAKE TESTIMONY

I.

The Commission has determined to investigate facts, conditions, practices and other matters, relating to the reasonableness of intra-member commission rate schedules of registered national securities exchanges, which it deems necessary and proper to aid in the enforcement of the provisions of the Securities Exchange Act of 1934 ("Exchange Act") to protect investors and to insure fair dealing in securities traded upon such exchanges and fair administration of such exchanges.

II.

IT IS ORDERED, pursuant to the Commission's authority under the Exchange Act, including, but not limited to, Exchange Act Section 21(a), 15 U.S.C. Section 78u(a), that an investigation be made of the matters referred to in Section I hereof to aid both in the administration of the provisions of the Exchange Act and in the prescribing of rules and regulations pursuant to Section 6, 11, 17(a), 19(b) and other pertinent provisions of the Exchange Act; and

IT IS FURTHER ORDERED, pursuant to the provisions of Section 22 of the Exchange Act, that a public hearing shall be held as part of this investigation, that the public hearing shall be conducted before the Commission, any member or members thereof, or William E. Toomey, who is hereby named as hearing officer and empowered to administer oaths and affirmations and to perform all other duties in connection therewith as prescribed by law, at the hearing which shall commence at 500 North Capitol Street, Washington, D.C. 20549 on May 29, 1974; and

IT IS FURTHER ORDERED, pursuant to the provisions of Section 21(b) of the Exchange Act, that for the purpose of such investigation and public hearing held as part of it Lee A. Pickard, Sheldon Rappaport and Gene L. Finn and each of them, is hereby designated an officer of the Commission and shall conduct the investigation and perform all other duties in connection therewith as prescribed by law.

By the Commission.

George A. Fitzsimmons
Secretary

For RELEASE Friday, September 24, 1971

Securities and Exchange Commission
Washington, D. C. 20549

Securities Exchange Act of 1934
Release No. 9351

The Securities and Exchange Commission today announced that it has sent the following letter to the New York Stock Exchange in response to the latter's commission rate proposal of June 28, 1971:

September 24, 1971

Mr. Robert W. Haack
President
New York Stock Exchange
11 Wall Street
New York, New York

Dear Mr. Haack:

The Commission has reviewed the proposed commission rates submitted by the New York Stock Exchange on June 28, 1971 pursuant to Rule 17a-8 and in light of the evidence presented at the public hearing on the proposal. As the Exchange has recognized, a rule dealing with commission rates is necessarily dependent for its validity upon the continuation of the conditions and circumstances justifying the reasonableness of the rates. Accordingly, the Commission expects that the Exchange will review its commission rate structure on a regular and systematic basis and will submit any appropriate modifications or changes in such structure to the Commission to enable it to exercise its continuing regulatory oversight. The Commission expects the Exchange to continue to gather necessary data from its members for this purpose. The Commission will also continue its monitoring program in order to assess the need for any rate changes.

As regards the present rate proposal, the inability of the Exchange appropriately to allocate costs and revenues between brokerage and other activities of its members has necessitated our consideration of the proposed rates on the basis of the total financial experience of Exchange member firms. We have considered the problems experienced by the securities industry in dealing with widely fluctuating volume levels in recent years, leading to back office problems and, in some cases, the insolvency of member firms. We find that the profitability of member firms during the first half of 1971 appears to be reasonable in view of significant changes in the operation and structure of the industry, including the introduction of competitive rates on certain large transactions, the forthcoming rules to protect customers' funds and securities and greater access by nonmember broker-dealers to the facilities of the Exchange. The Commission is continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. Accordingly,

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we reserve this matter for later determination in light of the evidence which is being developed.

On the basis of the evidence presented to us and the factors discussed above, the Commission does not object at this time to implementation of the Exchange's proposed rates, subject to the following conditions:

1. The present surcharge on certain transactions will be terminated as to all such transactions as soon as the Exchange, consistent with price restrictions referred to in subparagraph 10, may implement the new rate proposal.

2. In order to provide small investors with the continued opportunity to participate in the securities markets, no member organization that has traditionally handled small customer accounts will impose or continue any limitation of any kind on the size or frequency of any such customer's orders or the size of his account, nor will any member organizations impose fees, commissions or other charges on any such customer in excess of the proposed rates. The Exchange will establish an Investors' Service Bureau to assist small investors to participate in the markets, and will undertake a comprehensive and continuing effort to facilitate service to the small investor.

3. The rate schedule will be revised to provide that the total commission on an order consisting of a round-lot plus an odd-lot will not be higher than the commission on the next higher round-lot.

4. The intra-member rate will be reviewed by the Exchange in order to determine whether fixed charges should continue to prevail in this area. As regards the intra-member rate incorporated in the NYSE rate proposal, the Commission does not object at this time to that part of the proposal subject to the continuing consideration and review of the long-run desirability of the continuation of fixed intra-member charges and to the Commission's consideration of the industry structure questions in the hearings commencing October 12, 1971 and to the other conditions noted below.

(Continued)

5. The Commission finds that the provision for 30% access is inadequate and that the discount afforded nonmember broker-dealers should be not less than 40% to allow for a minimum meaningful test of this proposal. The Commission is reserving its final determination regarding the "primary purpose" limitation of the access provision until the completion of its scheduled hearings. The Commission will reconsider the access provision, including its "primary purpose" limitation, after the conclusion of the hearings scheduled to begin October 12, 1971. The Commission finds inappropriate the condition that it enforce the anti-rebate provisions of the Exchange's agreements for access by nonmembers. The responsibility for enforcing a rule adopted by a self-regulatory organization lies with that organization and the Commission's regulatory oversight will be exercised only to ensure that the rule and its administration by the self-regulatory organization are appropriate.

6. The Exchange will continue to ensure that commission revenues are prudently applied by all member organizations so as to improve further their capital positions and operational facilities.

7. The Exchange will, on or before May 1, 1972, submit to the Commission its proposals for implementing uniform reporting by member firms in order to permit evaluation of subsequent commission rate proposals, If the Exchange is unable to devise a suitable reporting mechanism, the Commission will consider doing so pursuant to Section 17(a) of the Securities Exchange Act.

8. The Exchange will examine its definition of an "order" to determine whether to alter the present provision so that portions of the same order executed on different days would be aggregated for purposes of ascertaining the applicable commission rate.

9. The Exchange will adopt rules or rule changes to enable member firms to enter into cooperative arrangements under which execution and clearance functions of such

firms could be performed jointly without the payment of intra-member rates for such functions to any other member.

10. The Exchange will comply with any restrictions on price increases imposed by law, as interpreted by the President's Cost of Living Council or any other organization designated by the President or the Congress to impose or interpret any such restrictions.

Sincerely yours,

William J. Casey

William J. Casey
Chairman

Mr. Robert W. Haack
President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Haack:

This is in response to your October 8, 1971 letter respecting the NYSE commission rate and access proposals.

You have asked that the Commission adopt a rule providing that a broker-dealer who provides a discount is not a "member" of the Exchange in a sense requiring that a change to regulate that firm as a member. We do not believe such a rule would be necessary. It is understood, however, that the Exchange's self-regulatory responsibility [illegible] broker-dealers who bring to it access provisions will not be the same as it is for its members or affiliates. Indeed, we believe it appropriate for purposes of the Exchange's access proposals to view registered broker-dealers who are subject to Exchange or SEC supervision and which own not more than one membership of the Exchange by virtue of seat ownership to be a special class of public customers. Accordingly, we do not believe it is necessary nor the Commission to adopt a rule such as you requested in your letter of October 8, 1971. However, as you know, the Commission is considering in the public hearings which began on October 12, 1971 [illegible] to the access question and should there be any change in the Commission's position in this regard, you will be so advised.

Donald L. Calvin has advised that Article XV, Section 2(d) (Exhibit C to your letter of October 1) will be amended by adding several words at the end to provide inter alia "commissions shall be charged and collected at the rates prescribed in this Section 2 on the execution of any small orders [illegible] all accounts." It is further understood that enabling [illegible] on the books or rules will be amended thereto in addition to existing [illegible], or otherwise, to implement condition 2 of the Commission's Sept. 21 letter and that these changes will be implemented when the new rules have become effective.

The Commission's determination not to object to certain Exchange proposals at this time should not be construed as a final disposition of the questions involved in the proposed rules or in other rules adopted by the Exchange.

Sincerely yours,

William J. Casey
Chairman

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
GENERAL COUNSEL

May 24, 1974

A. Daniel Fusaro, Esquire
Clerk, United States Court of Appeals
for the Second Circuit
United States Courthouse
Foley Square
New York, New York 10007

Re: Gordon v. New York Stock Exchange, Inc., No. 74-1043 (C.A. 2)

Dear Mr. Fusaro:

Enclosed for filing with the Court in the above-referenced case, pursuant to Rule 29 of the Federal Rules of Appellate Procedure, are twenty-five (25) copies of the Brief of United States Securities and Exchange Commission, Amicus Curiae.

I hereby certify that on May 24, 1974, I caused to be served by United States mail, first class, postage prepaid, a true copy of the Commission's brief upon the following:

I. Walton Bader, Esquire
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Attorney for Amicus Curiae
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Washington, D.C. 20530

Sincerely,

Frederic T. Spindel

Frederic T. Spindel
Special Counsel

Enclosures